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IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. .....
76-1478

H. ROSS PEROT, ELECTRONIC DATA SYSTEMS CORPORATION, duPONT GLORE FORGAN INCORPORATED, WILLIAM K. GAYDEN, MORTON H. MEYERSON, MILLEDGE A. HART, III, MARGOT PEROT, MERVIN L. STAUFFER, PHM & Co., CHARLESTON INVESTMENT COMPANY, E.D. SYSTEMS CORPORATION, DANIEL J. CULLEN, WILLIAM D. FLEMING, GEORGE T. THOMSON and CHARLES W. COX, *Petitioners,*

v.

WINTHROP J. ALLEGAERT,
as Trustee of duPont Walston Incorporated,
Respondent,

- and -

NEW YORK STOCK EXCHANGE, INC., DOUGLAS E. DeTATA, JOHN J. DOUGHTY, ALLAN BLAIR and D. TIPP CULLEN, *Additional Respondents.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

April 25, 1977

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v.

WINTHROP J. ALLEGAERT,
as Trustee of duPont Walston Incorporated,
Respondent,

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NEW YORK STOCK EXCHANGE, INC., DOUGLAS E. DeTATA, JOHN J. DOUGHTY, ALLAN BLAIR and D. TIPP CULLEN, *Additional Respondents.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioners[1] respectfully pray that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, which

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[1] Petitioners, all of whom are named defendants in this action, are four corporations (Electronic Data Systems Corporation, E. D. Systems Corporation, duPont Glore Forgan Incorporated and Charleston Investment Company), one partnership (PHM & Co.)

reversed a judgment of the United States District Court for the Southern District of New York granting petitioners' Motion to Stay Proceedings and to Compel Arbitration brought pursuant to Section 3 of the United States Arbitration Act.

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 548 F.2d 432 and is set forth in Appendix A. The unreported opinion of the District Court and its ancillary orders with respect thereto are set forth in Appendix B.

JURISDICTION OF THE COURT

The judgment sought to be reviewed was entered on January 25, 1977 (App. A, p. 1a). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

1. Whether a Federal court may refuse to enforce comprehensive, binding arbitration agreements solely on the grounds of its belief that there may be a "public interest" in the outcome of the dispute and that "the availability of discovery in arbitration is uncertain"? The court below, adopting a case-by-case analysis approach, refused to enforce three governing arbitration agreements for those two reasons.

2. Whether the provisions of the Constitutions of the New York and American Stock Exchanges compelling arbitration of disputes between exchange members, or between members and non-members at the insistence of the non-members, become unenforceable when disputes under the Federal securities laws arise between member firms? Notwithstanding the mandate of Section 28(b) of the Securities Exchange Act of 1934, the court below held that, except for "mere internal brokerage industry squabble[s]," arbitration could not be compelled.

3. Whether a trustee in bankruptcy, who sues alleged debtors of a bankrupt estate in a plenary action, asserting claims which arise, in part, under sections of the Bankruptcy Act, but which concededly are encompassed within the scope of arbitration agreements binding on the bankrupt, is immune from arbitrating those claims? The court below held that a trustee could not be compelled to arbitrate such claims.

4. Whether Section 29(a) of the Securities Exchange Act of 1934 bars arbitration of claims brought pursuant to the implied right of action under Rule 10b-5 of the Securities and Exchange Commission? The court below held that it did.[2]

STATUTES AND RULES INVOLVED

This case involves Sections 2 and 3 of the United States Arbitration Act (the "Arbitration Act"), 9

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and ten individuals (H. Ross Perot, William K. Gayden, Morton H. Meyerson, Milledge A. Hart, III, Margot Perot, Mervin L. Stauffer, Daniel J. Cullen, William D. Fleming, George T. Thomson and Charles W. Cox).

[2] This question, which is not discussed in the Reasons for Granting Certiorari, is stated here to preserve it if this petition is granted. It is the same question noted but not decided in Justice Stewart's opinion for the Court in *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506, 513-514 (1974). See also Justice Stevens' dissent in the Seventh Circuit's decision in *Scherk*, in which Justice Stevens discussed at length the reasons *Wilko* v. *Swan*, 346 U.S. 427 (1953) ought not to apply to Exchange Act claims arising from complex business dealings among sophisticated equals. 484 F.2d 611, 615-619 (1973).

U.S.C. §§ 2 and 3; Sections 10(b), 28(b) and 29(a) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. §§ 78j(b), 78bb(b), 78cc(a); Section 14 of the Securities Act of 1933 (the "Securities Act"), 15 U.S.C. § 77n; Sections 26, 60b, 67d and 70e of the Bankruptcy Act, 11 U.S.C. §§ 49, 96(b), 107(d) and 110(e); Rule 10b-5 of the Securities and Exchange Commission, 17 C.F.R. 240.10b-5; and Rule 919(b) of the Bankruptcy Rules, the texts of all of which are set forth, in pertinent part, in Appendix C.

STATEMENT OF THE CASE

This petition arises from the refusal of the Court of Appeals to enforce three separate and all-encompassing arbitration agreements. Contrary to the explicit mandate of Section 3 of the Arbitration Act and the national policy enunciated therein, it was the court's view that arbitration would be "inappropriate" for resolution of Federal securities laws and Bankruptcy Act claims. The undisputed material facts are as follows:

For many years prior to its bankruptcy duPont Walston Inc. ("Walston"), a retail brokerage firm, was a member of the New York Stock Exchange, Inc. ("NYSE"), the American Stock Exchange, Inc. ("AMEX") and other national securities exchanges. As such, Walston was bound by the Constitutions of the NYSE and the AMEX, including the comprehensive arbitration provisions contained in each which require arbitration of *"any"* controversies between it and other exchange members and *"any"* controversies between it and non-members which arise out of its business when the non-member elects arbitration of such controversies (NYSE Const. Art. VIII, Sec. 1; AMEX Const. Art.

VIII, Sec. 1 (Appendix D)). In addition to Walston, twelve of the defendants below (of whom eight are petitioners here) were also members or allied members of the NYSE and/or the AMEX at the time the relevant transactions took place. Seven of the defendants below (all petitioners here) were non-members seeking to enforce their right to compel arbitration of their dispute with Walston, a member firm of both national securities exchanges at the time the controversy arose.

This action was commenced on July 1, 1975 by Winthrop J. Allegaert, the trustee in bankruptcy of Walston (hereinafter "Allegaert" or the "Trustee"). All of Allegaert's claims arise out of the July 2, 1973 realignment of the businesses of Walston and petitioner duPont Glore Forgan Incorporated ("DGF, Inc."), another brokerage firm which also was a member corporation of the NYSE and the AMEX. That realignment was accomplished pursuant to a series of written agreements (the "Realignment Agreements") dated and effective as of July 2, 1973, whereby Walston assumed all front office operations and DGF, Inc. assumed all back office functions of the two firms. (In addition to the arbitration provisions in the NYSE and AMEX Constitutions, one of the Realignment Agreements (the Master Agreement) also contains a broad and comprehensive arbitration clause covering *"any"* dispute arising under the Realignment Agreements (Article 10.11 of Master Agreement to Realignment Agreements) (App. D, p. 45a).

The Trustee's complaint (Appendix E) asserts twenty-four separate counts including eight counts under the Federal securities acts (both the Securities Act and the Exchange Act), seven counts under Sections 60, 67 and 70 of the Bankruptcy Act, three counts un-

der New York and Delaware statutes, and six counts under the common law.[3]

Allegaert's allegations are wholly unproven. He has stated of record that he has "no personal knowledge of the facts" alleged in his complaint. The Court of Appeals noted in its opinion that it "of course, express[es] no view as to whether the trustee's allegations, particularly those charging fraud and wrongdoing, are correct" (App. A, p. 5a n. 2).

PROCEEDINGS BELOW

(a) District Court Proceedings

After the complaint had been filed, fifteen of the defendants, the petitioners herein, moved under Section 3 of the Arbitration Act (9 U.S.C. § 3), for a stay of the proceedings pending arbitration of all of the claims against them.

District Judge Whitman J. Knapp granted petitioners' motion and, in the exercise of his discretion and inherent power to control his docket, stayed the action as to the NYSE and the non-petitioning defendants as well (App. B, p. 34a). The District Court found that: (i) all fifteen of the petitioners were persons entitled to demand arbitration under one or more of the three applicable arbitration agreements (App.

[3] The District Court correctly summarized the complaint as charging in essence that the defendants had conspired to mislead Walston into approving the realignment transaction and executing the Realignment Agreements, that DGF, Inc. had breached the Realignment Agreements, and that certain of the defendants had misappropriated Walston's assets in carrying out those agreements. (App. B, p. 19a.) The complaint posits Federal jurisdiction upon the claims asserted under the Securities and Exchange Acts and the Bankruptcy Act and principles of pendent jurisdiction.

B, p. 22a n.6); (ii) Allegaert's general status as a trustee in bankruptcy did not relieve him of the obligation to submit to arbitration pursuant to Walston's arbitration agreements where the claims sought to be arbitrated were claims brought by the Trustee for the benefit of the estate and were not claims against the estate (App. B, pp. 24a-25a); (iii) the "only argument" which the Trustee could muster in support of his "rather vague" contentions "that arbitration would be counter to public policy"—to wit: Allegaert's fear "that somehow an arbitration tribunal would be 'friendly' to the defendants"—was unsubstantiated by any record evidence and contrary to decided case law (App. B, p. 29a); (iv) Allegaert's securities law claims were not immune from arbitration because Section 28(b) of the Exchange Act exempts the NYSE and AMEX Constitutions from the nonwaiver provisions of the Federal securities laws when arbitration is sought *against* an NYSE or AMEX member and because the public policy considerations underlying the rule of *Wilko* v. *Swan,* 346 U.S. 427 (1953) (hereinafter "*Wilko*") were in applicable in such cases (App. B, pp. 29a-30a); and (v) Allegaert's specific bankruptcy law claims (under Sections 60, 67 and 70) were also arbitrable, since the contractual right to demand arbitration did not cease to be effective "simply because [the Trustee] has the power to recover fraudulent transfers and voidable preferences," and "nothing in the [Bankruptcy] Act ... grants the bankrupt an absolute right to a choice of forum" (App. B, p. 28a).

(b) The Court of Appeals' Opinion

The Court of Appeals reversed, holding that Allegaert could not be compelled to arbitrate the Federal

securities laws and Bankruptcy Act claims asserted in his complaint. It held, first, that the question of the enforceability of an arbitration agreement should be determined in each case arising under Federal statutes based upon a nebulous three-prong test in which the District Courts would be required to examine: (i) the extent of "the public interest in the dispute";[4] (ii) "the degree to which the nature of the evidence made the judicial forum preferable to arbitration";[5] and (iii) the "extent to which the agreement to arbitrate was a product of free choice."[6] (App. A, p. 10a.)

The court below then held the Bankruptcy Act claims not arbitrable because "the trustee asserts them for the benefit of the bankrupt's creditors" who, if they had asserted such claims themselves "would not have been subject to any arbitration agreement" (App. A, pp. 8a-9a).

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[4] The court stated that it found a significant "public interest" in this case because (i) the claims arose in connection with "one of the most celebrated brokerage house failures in the history of Wall Street," and (ii) the Bankruptcy Act claims "are asserted on behalf of many hundreds of creditors." (App. A, p. 10a).

[5] With respect to this "test," the court noted only that unlike an operating business, the Trustee employs no witnesses with knowledge of the relevant facts and claims that he has almost none of the relevant documents. This is significant, the court stated, because the "availability of discovery in arbitration is uncertain." (App. A, p. 10a).

[6] Since the agreements to arbitrate reflected in the NYSE and AMEX Constitutions were entered into by Walston years before the execution of the Realignment Agreements and were clearly the product of Walston's free choice in determining to join the exchanges, the Court of Appeals recognized that this "consideration" is not a factor in this case. (App. A, p. 10a).

The Court of Appeals also held that arbitrability of the Federal securities laws claims asserted by Allegaert could not be compelled even though the dispute arose out of securities transactions between members of the exchanges and non-members who sought to compel arbitration. It relied on this Court's decision in *Wilko, supra,*[7] which had construed the effect of Section 14 of the Securities Act on an arbitration provision included in a customer's margin agreement (App. A, pp. 10a-11a).

Accordingly, the Court of Appeals remanded the case to the District Court with an order that Allegaert be allowed to pursue his claims under the Federal securities and bankruptcy laws "immediately . . . prior to arbitration of any of the remaining claims."[8] (App. A, p. 13a.)

REASONS FOR GRANTING THE WRIT

This case raises fundamental questions regarding the arbitrability of disputes arising under the Federal securities laws and the bankruptcy laws, each of which

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[7] It also relied on its own decision in *Greater Continental Corp.* v. *Schechter,* 422 F.2d 1100 (1970) a case not involving exchange members or the exchange Constitutions in any way, which, in *dicta,* indicated the unavailability of arbitration to resolve Section 10(b) claims.

[8] The order that trial of the Trustee's securities and Bankruptcy Act claims precede arbitration is itself inconsistent with the explicit language of Section 3 of the Arbitration Act which states that upon determining that "any issue" in a case is referable to arbitration under a written arbitration agreement, "the court shall . . . stay the trial of the case until such arbitration has been had in accordance with the terms of the agreement." See, *e.g., N.V. Maatschappij Voor Industriele Waarden* v. *A. O. Smith Corp.,* 532 F.2d 874, 875-877 (2d Cir. 1976).

was resolved by the Court of Appeals in a way which (i) effectively reverses the strong Federal policy in favor of arbitration established by the Arbitration Act and repeatedly endorsed by prior decisions of this Court, and (ii) threatens to compel District Courts to handle massive amounts of new substantive litigation previously referable to arbitration when such disputes arise under Federal statutes and expanded procedural litigation relating to the enforceability of arbitration agreements.

Even in its narrowest reading, the decision below jeopardizes the unilateral right granted to customers and others who deal with member firms of the national securities exchanges to compel such members to arbitrate disputes and thereby to avoid the cost and delay of court litigation. In its reasoning, the decision below also threatens all arbitration agreements (including the mandatory arbitration agreements typically contained in the by-laws or other rules of business or commercial associations) whenever disputes arise under Federal statutes, for any party to such a dispute can now make a colorable claim as to the unenforceability of the arbitration agreement and thus effectively delay the resolution of the dispute and geometrically compound its cost, by merely filing a complaint and alleging public interest overtones in the outcome of the case and its need for discovery.

Moreover, the holding below directly conflicts with a holding of the First Circuit that when disputes arise among members of the national securities exchanges, the compulsory arbitration provisions of the exchange Constitutions must be enforced to effectuate Congress' mandate of national stock exchange self-regulation.

Finally, the decision presents "significant" questions regarding the "interplay" and "policy" of two Federal statutes (App. A, pp. 3a, 12a) on which this Court has yet to rule.

I. THE DECISION BELOW EFFECTIVELY NULLIFIES THE POLICY OF THE UNITED STATES ARBITRATION ACT WHENEVER AN ARBITRABLE DISPUTE ARISES UNDER A FEDERAL STATUTE AND DIRECTLY CONFLICTS WITH A DECISION OF THIS COURT.

The Arbitration Act sets forth clear standards for determining the enforceability of arbitration agreements satisfying the jurisdictional requirements of the Act.* Section 3 of the Act states that in any suit brought in any Federal court, upon being satisfied that any issue is referable to arbitration under a written arbitration agreement:

> "[T]he court . . . shall . . . stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement. . . ."

Interpreting this language in *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967) (hereinafter *"Prima Paint"*), this Court held that this provision means what it says:

> "We hold, therefore, that in passing upon a § 3 application for a stay while the parties arbitrate, a federal court may consider only issues relating to the making and performance of the agreement to arbitrate. In so concluding, we not only honor the plain meaning of the statute but also the un-

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* In this case there is no question that the jurisdictional requirements of the Act have been satisfied, since all three arbitration agreements sought to be enforced clearly involve interstate commerce.

> mistakably clear congressional purpose that the arbitration procedure . . . be speedy and not subject to delay and obstruction in the courts." 395 U.S. at 404.

In holding that arbitrability of the Federal statutory claims in this case was to be determined by a case-by-case assessment of "whether such claims are of a character inappropriate for enforcement by arbitration," (App. A, p. 10a), the decision of the court below was flatly inconsistent with both the clear and explicit language of Section 3 of the Arbitration Act, as set forth above, and the holding and policies articulated by this Court in *Prima Paint.*

The Court of Appeals' "appropriateness" test also ignores the clear intent of Congress in enacting Section 2 of the Arbitration Act that arbitration agreements be placed "upon the same footing as other contracts. . . ."[10] In this case, in particular, two of the arbitration agreements sought to be enforced—the arbitration clauses of the NYSE and AMEX Constitutions—were entered into years before this dispute arose and cannot possibly be said to be invalid as a matter of state contract law.[11] The Court of Appeals'

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[10] H.R. Rep. No. 96, 68th Cong., 1st Sess. 1, 2 (1924), quoted by the Court in *Scherk* v. *Alberto-Culver Co., supra,* 417 U.S. at 511.

[11] Federal courts have considered the enforceability of these agreements on numerous occasions, and uniformly have held that they are valid and binding as a matter of state contract law, and satisfy all the other requirements for enforcement under the Act. *Muh* v. *Newburger, Loeb & Co., Inc.,* 540 F.2d 970, 973 (9th Cir. 1976); *Dickstein* v. *duPont,* 443 F.2d 783, 785 (1st Cir. 1971); *Legg, Mason & Company* v. *Mackall & Coe, Inc.,* 351 F. Supp. 1367, 1369-1371 (D.D.C. 1972); *Isaacson* v. *Hayden, Stone, Inc.,* 319 F.Supp. 929, 930 (S.D.N.Y. 1970); *Osborne & Thurlow* v. *Hirsch & Co.,* 10 Misc. 2d 225, 175 N.Y.Supp. 2d 522 (Sup. Ct. 1958). Indeed, the Court of Appeals implicitly held that these agreements were enforceable in this very case, by refusing to reverse that portion of Judge Knapp's order which directed arbitration of Allegaert's state statutory and common law counts, many of which raise factual and legal issues virtually identical to the Federal statutory claims.

view that the asserted need for discovery makes litigation "preferable" to arbitration and that the supposed "public interest" in this dispute makes arbitration "inappropriate," simply is not a basis for refusing to permit arbitration, any more than such a view would permit a court to refuse to enforce any other contract.

Moreover, although not directly in conflict with their narrowest holdings, the hostility to arbitration evidenced by the decision of the court below also conflicts sharply with the policies articulated by this Court in *Nolde Bros., Inc.* v. *Local No. 358, Bakery & Confectionary Workers Union,* 45 U.S.L.W. 4251 (March 7, 1977); *Scherk* v. *Alberto-Culver Co.,* 417 U.S. 506 (1974) (hereinafter *"Scherk"*),[12] and indeed *Wilko* itself.[13]

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[12] There, this Court said that "an agreement to arbitrate before a specified tribunal is, in effect, a specialized kind of forum-selection clause" and that the "solemn promise" reflected by such an agreement should not be invalidated simply because of a "parochial concept that all disputes must be resolved . . . in our courts." 417 U.S. at 519.

[13] In *Wilko,* the majority opinion stated:

> "The United States Arbitration Act establishes by statute the desirability of arbitration as an alternative to the complications of litigation. The reports of both Houses on that Act stress the need for avoiding the delay and expense of litigation, and practice under its terms raises hope for its usefulness both *in controversies based on statutes,* or on standards otherwise created." 346 U.S. at 431-432 (footnotes omitted) (emphasis supplied).

Prior to the unprecedented decision of the court below, the arbitrability of claims under Federal statutes generally, (and under the Federal securities acts and the Bankruptcy Act in particular), were governed by clear, predictable and easily applied rules of law which did not require the District Courts to determine arbitrability on a subjective case-by-case basis. Arbitration agreements had been enforced in all manner of disputes arising under Federal statutes (see, *e.g., Wilko* at 432 n. 13; *Fallick* v. *Kehr,* 369 F.2d 899, 903 n. 9). Enforcement of arbitration agreements had been denied only in a limited number of areas where whole classes or categories of claims were held to be nonarbitrable, based upon explicit Federal statutes which denied the enforceability of such agreements without regard to the specific facts alleged in a particular complaint.[14] Now, according to the court below, the arbitrability of claims under Federal statutes must be determined, not as generic rules of law based upon statute, but by the District Courts after analysis on a case-by-case basis, conducted at the pleading stage, and frequently, as here, before an answer has been filed, of the alleged facts and circumstances of *each* such case, in order to assess, "among other [unspecified] things" the essentially unquantifiable "public interest" in the case, and the extent to which a judicial forum is deemed more "preferable" for the resolution of the controversy because of the "nature of the evidence" and the issues in the case, or the need of discovery of the party resisting arbitration.[15] (App. A, p. 10a.)

If allowed to stand, the Court of Appeals' decision will thus dramatically increase the burden on the Federal District Courts in administering the Arbitration Act and the burden on parties to arbitration agreements who seek to enforce such agreements against adversaries who will gain tactically by delay and increased expense in the resolution of controversies. It concommitantly will decrease the ability of parties to act predictably on the basis of their solemn promises to arbitrate.

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[14] *E.g., all* claims arising under the Securities Act in which a customer was involved in a dispute with a broker and the customer resisted arbitration (*Wilko, supra*); all claims arising under the Sherman Antitrust Act where the alleged monopolist insisted on arbitration in an adhesion contract (*American Safety Equip. Corp.* v. *J.P. Maguire & Co.,* 391 F.2d 821 (2d Cir. 1968)); *all* claims *against* a trustee in bankruptcy which sought to diminish the assets of the bankrupt estate (*Johnson* v. *England,* 356 F.2d 44 (9th Cir.), *cert. denied,* 384 U.S. 961 (1966)); all claims of seamen for wages arising under 46 U.S.C. § 596 (*U.S. Bulk Carriers, Inc.* v. *Arguelles,* 400 U.S. 351 (1971)).

[15] In *American Safety Equip. Corp.* v. *J. P. Maguire & Co., supra,* the case on which the court below placed principal reliance, the Court of Appeals specifically noted that, if the plaintiff's allegations were correct, the agreement containing the arbitration contract "itself was an instrument of illegality" under the Sherman Act. 391 F.2d at 827. Enforcing the arbitration clause of such agreement thus would be allowing "contracts of adhesion between alleged monopolists and their customers . . . [to] determine the forum for trying antitrust violations," in contravention of the purposes of the Federal statute (*id.*). In this case, the arbitration agreements sought to be enforced are polar opposites of contracts of adhesion, *viz.*, arbitration provisions of exchange Constitutions, established pursuant to an Act of Congress requiring self-regulation by national stock exchanges and required to be "fair" as a precondition to exchange registration under the Exchange Act, Section 6(b), 15 U.S.C. § 78f(b), and entered into by Walston years before the execution of the agreements from which the dispute arises.

II. THE DECISION BELOW CONFLICTS WITH A DECISION OF THE FIRST CIRCUIT INTERPRETING SECTION 28(b) OF THE EXCHANGE ACT. CONFLICTS WITH THE POLICY ARTICULATED IN THE COURT'S SCHERK DECISION AND SUBSTANTIALLY INVALIDATES THE ARBITRATION PROVISIONS OF THE NYSE AND THE AMEX CONSTITUTIONS.

The court below held that "the presence of the securities law claims further supports the need for a judicial tribunal here." (App. A, p. 10a.) Departing from the unbroken line of cases in which arbitration of securities fraud disputes encompassed by the arbitration provisions of the NYSE or AMEX Constitutions was compelled, the court held that "the strong federal policy in favor of determining stock fraud questions in the federal courts" precluded arbitration here. (App. A, pp. 10a-11a.)

In so holding, the court's opinion squarely conflicts with the decision of the First Circuit in *In Re Revenue Properties Litigation Cases (Cohn, Delaire & Kaufman)*, 451 F.2d 310 (1971) (hereinafter "*Revenue Properties*"), conflicts with the policy articulated by this Court in *Scherk,* and substantially invalidates the mandatory arbitration clauses in the Constitutions of the NYSE and AMEX—provisions which grant very important rights of forum selection to customers and others who deal with exchange member firms.

A. The Conflict with the First Circuit

In *Revenue Properties,* which, as here, involved disputes among exchange member firms arising under the Federal securities acts, the First Circuit held that the nonwaiver section of the Securities Act—Section 14—could have no applicability to the arbitration agreement contained in the AMEX Constitution because Section 14 is applicable only to any "condition . . . binding any person acquiring a security."

> "[Broker] was subject to a binding provision to arbitrate but in its capacity as a member of the exchange, with the attendant benefits and the concurrent statutorily-imposed responsibilities of such position. The agreement to arbitrate was not imposed as a requirement for the acquisition of a security or as a supposed inducement to its sale." 451 F.2d at 313.

The First Circuit also held that the nonwaiver section of the Exchange Act—Section 29(a)—could have no applicability to the dispute before it which involved two members of the AMEX because of the overriding impact of Section 28(b) of the Exchange Act,

> "which specifically recognizes the binding effect of exchange action to settle disputes between members." *Id.*

Finally, the First Circuit expressly rejected the argument which the court below accepted—that cases involving securities act claims which raise "broad questions of policy which ordinarily should be handled by the judiciary" are not encompassed within the ambit of Section 28(b) of the Exchange Act. (App. A, p. 12a.) The First Circuit held:

> "[Broker] points out that if it is compelled to arbitrate, issues important to the securities industry could be decided, with only the limited review envisaged by 9 U.S.C. § 10. The logic of this argument implies a prerequisite to arbitrability: that only issues not heavily invested with legal significance be decided. But no area of arbitration is guaranteed to be kept insulated from important issues of substantive law." *Id.*

The brokerage firm in the *Revenue Properties* case, like Allegaert, had placed its reliance on *Wilko*. The First Circuit held *Wilko*, which "dealt with margin agreements containing arbitration clauses which a buyer entered into in connection with his purchases," inapplicable to disputes between exchange members where the arbitration agreement "stemmed . . . from the provisions of the exchange constitution and rules" to which the brokers "had freely assented when they became members of the exchange." (*Id.*) Totally ignoring the statutory rationale of *Wilko*, and the policy considerations on which it turned,[16] the court below held *Wilko* controlling.

B. The Conflict with This Court's Decision in *Scherk*

The court below, in holding that "the strong federal policy in favor of determining stock fraud questions

[16] In *Wilko*, the issue before this Court was whether § 14 of the Securities Act barred arbitration of a *customer's* Securities Act claims pursuant to the arbitration clause of the customer's margin agreement with his broker-dealer entered into at the time of the customer's purchase of securities. In deciding this question, the Court carefully weighed the competing policies embodied in § 14 of the Securities Act and the Arbitration Act—noting that these competing statutory provisions presented it with "two policies, not easily reconcilable"—and then concluded that the customer's arbitration agreement was a "condition, stipulation, or provision binding any person acquiring any security to waive compliance with the provisions [of the Act]" within the scope of § 14, and thus void under the express language of that section. *Wilko, supra*, 346 U.S. at 430, 434-435, 438. In reaching this conclusion, the Court emphasized the importance of the policy established by the Securities Act of protecting customers, such as the small investor in that case, 346 U.S. at 431, 433. It also stressed the danger that if customers could be compelled to arbitrate, broker-dealers might be able to take advantage of the inferior bargaining position of customers "at a time when [the customer] is less able to judge the weight of the handicap the Securities Act places on his adversary," 346 U.S. at 435.

in the federal courts" was determinative, also ignored the contrary conclusion of this Court in *Scherk, supra*. There, this Court expressly required arbitration of Alberto-Culver's "stock fraud questions" at Scherk's insistence in enforcing the parties' arbitration agreement. The Court rejected Alberto-Culver's misplaced reliance on *Wilko*, and held that the applicable sections of the Arbitration Act (in that case §§ 201 *et seq.*) no longer permitted the "parochial concept" that only courts are capable of determining securities fraud issues. 417 U.S. at 519. In *Scherk*, as here, the arbitration clause was the product of bargaining among sophisticated equals.

C. The Impact on the Arbitration Provisions of the NYSE and AMEX Constitutions[17]

Every prior case in the Second Circuit (and elsewhere) in which the courts have decided issues relating to the arbitrability of securities fraud disputes involving members of the national securities exchanges has held that such disputes are arbitrable pursuant to the exchanges' Constitutions which are an exercise of the exchanges' self-regulatory powers pursuant to Section 28(b) of the Exchange Act. See, *e.g., Axelrod & Co.* v. *Kordich, Victor & Neufeld*, 451 F.2d 838 (2d Cir. 1971);[18] *Coenen* v. *R. W. Pressprich & Co., Inc.*, 453

[17] This point is discussed more fully in the Brief of Respondent New York Stock Exchange, Inc. in Support of Petition for Certiorari, and accordingly will be touched on only briefly here.

[18] Which Justice Stevens read as "demonstrating that § 28(b) of the 1934 Act *made it perfectly clear* that § 29(a) did not preclude enforcement of the compulsory arbitration rules of the [NYSE]," *Alberto-Culver Co.* v. *Scherk*, 484 F.2d 611, 619 n.13 (7th Cir. 1973) (dissenting opinion), *rev'd*, 417 U.S. 347 (1974) (emphasis supplied).

F.2d 1209 (2d Cir.), *cert. denied,* 406 U.S. 949 (1972);[19] *Brown* v. *Gilligan, Will & Co.,* 287 F. Supp. 766 (S.D.N.Y. 1968).[20] The decision below, which for the first time holds to the contrary, thus creates uncertainty and enormous further litigation potential over the enforceability of arbitration agreements in the very Circuit in which the overwhelming majority of such disputes ordinarily arise. By ignoring the overriding statutory scheme of supervised self-regulation for stock exchanges included in the Exchange Act, which it had previously recognized and enforced, the court below has turned a self-executing rule designed to promote the objective of speedy and inexpensive resolution of disputes into a fluid rule *where any broker can avoid the obligation to arbitrate with non-members or other members who seek to compel arbitration of securities fraud disputes* simply by asserting in a Federal District Court that the dispute involves "broad questions of policy" and by labelling such disputes as not

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[19] There, the arbitration clauses of the exchange Constitutions were characterized as "the *most* significant of the measures taken to implement the self-regulation contemplated by the 1934 Act." 453 F.2d at 1215 (emphasis supplied).

[20] The holdings in these cases also have been expressly approved by the Ninth Circuit in *Muh* v. *Newburger, Loeb, supra,* 540 F.2d at 972-973, by the Third Circuit in *Ayres* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 538 F.2d 532, 538 n. 18, *cert. denied,* 45 U.S. L.W. 3416 (Dec. 6, 1976) and by the District Court for the District of Columbia in *Legg, Mason & Co., Inc.* v. *Mackall & Coe, Inc., supra,* 351 F. Supp. at 1371-1372. See also this Court's decision in *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware,* 414 U.S. 117, 135 n. 15 (1973) which cited *Coenen* v. *R. W. Pressprich & Co., Inc., supra,* with approval, and Justice Stevens' dissent in the Seventh Circuit's opinion in *Scherk* v. *Alberto-Culver Co., supra,* 484 F.2d at 619 n.13.

merely an "intramural" dispute among "industry members." Thus, customers and other non-members—like seven of the petitioners here—who assert their unilateral right to demand arbitration *against* exchange member firms can now have their arbitration demands rejected by member firms who seek to deny their customers the speedy and inexpensive resolution of disputes which arbitration affords, turning *Wilko* on its head and effectively invalidating Section 28(b) of the '34 Act and the actions taken by the exchanges pursuant thereto.

III. THE COURT OF APPEALS' REFUSAL TO PERMIT ARBITRATION OF THE TRUSTEE'S BANKRUPTCY ACT CLAIMS PRESENTS AN IMPORTANT QUESTION OF FEDERAL LAW NOT PREVIOUSLY CONSIDERED BY THIS COURT.

As the Second Circuit stated, this case raises "significant questions" regarding the "interplay" between the "policy" of the Arbitration Act and the Bankruptcy Act. (App. A, pp. 3a, 12a.) This Court has never considered questions of arbitrability in a bankruptcy context. Given the ever-increasing use of arbitration agreements in all types of commercial arrangements, due in large measure to this Court's holding in cases like *Prima Paint,* the question of the survival of arbitration agreements after bankruptcy is a matter of national importance which should be considered by this Court.

It is a fundamental rule of bankruptcy law that, absent a specific statutory provision to the contrary, a trustee in bankruptcy is bound by the contractual obligations of the bankrupt. *Bank of Marin* v. *England,* 385 U.S. 99, 101 (1966).

Consistent with this principle, prior to the decision in this case, it had been repeatedly said that a trustee is bound by the bankrupt's pre-bankruptcy arbitration agreements if the trustee *seeks to bring suit outside of the bankruptcy court* against alleged wrongdoers who had not asserted claims against the estate. *Truck Drivers Local Union No. 807* v. *Bohack Corp.*, 541 F.2d 312 (2d Cir. 1976); *Tobin* v. *Plein*, 301 F.2d 378 (2d Cir. 1962); *Schilling* v. *Canadian Foreign S.S. Co., Ltd.*, 190 F. Supp. 462 (S.D.N.Y. 1961). This had been the rule regardless of whether it was the trustee or the creditor who was seeking arbitration.[21] In *Schilling*, which was expressly approved by the Second Circuit in *Tobin* and most recently in *Truck Drivers*, the court asked:

> "whether a trustee in reorganization who seeks to recover on a contract made with his debtor prior to the beginning of the reorganization proceeding may be compelled to proceed to arbitration in accordance with a provision in the contract." 190 F. Supp. at 461.

The answer was as follows:

> "The right of a party to a contract to resort to arbitration provided for in that contract is as

[21] Conversely, it had been held that a trustee could not be compelled to arbitrate claims asserted *against* the bankrupt's estate for arbitration of such claims would affect the amount, existence and priority of claims to be paid out of the estate's general funds, matters which the Bankruptcy Act expressly places within the *exclusive jurisdiction* of the bankruptcy court. See, *e.g.*, *In re Muskegon Motor Specialties Co.*, 313 F.2d 841 (6th Cir.), *cert. denied*, 375 U.S. 832 (1963); *Johnson* v. *England*, 356 F.2d 44, *supra*; *Designers' Guild* v. *Hers Apparel Indus. Inc.*, 76 CCH Lab. Cases ¶ 10,773 (S.D.N.Y. 1975); Kriendler, *The Convergence of Arbitration and Bankruptcy*, 26 Arb. J. 34, 38-39 (1971).

> much a contract right as is the right to payment... The trustee by forcing [the defendant] to trial ... would be depriving [the defendant] of the right to arbitration for which it had bargained. ... Bankruptcy does not, however, deprive the bankrupt's debtors of their rights." *Id.* at 463.

Other than noting the tautologically correct statements that (i) a bankruptcy trustee is a "new entity ... with its own rights and duties, subject to the supervision of the bankruptcy court;"[22] and (ii) the Bankruptcy Act claims asserted in the complaint "are statutory causes of action belonging to the trustee, not to the bankrupt, and the trustee asserts them for the benefit of the bankrupt's creditors, whose rights the trustee enforces," (App. A, pp. 8a-9a) the court below offers no rationale or justification (and cites no authority) for rejecting the clear mandate of the Arbitration Act and holding that the Trustee is excused from arbitrating his Bankruptcy Act claims. In fact, there is no such authority in the statute or the cases.

Notably, the Court of Appeals expressly acknowledged that, irrespective of its "new entity" observa-

[22] The Court of Appeals had made this observation in *Shopmen's Local Union No. 455* v. *Kevin Steel Prod. Inc.*, 519 F.2d 698, 704 (2d Cir. 1975) and repeated it in *Brotherhood of Railway Clerks* v. *REA Express, Inc.*, 523 F.2d 164 (2d Cir. 1975), *cert. denied*, 423 U.S. 1017, 1073 (1976). But in *Matter of Unishops, Inc.*, 543 F.2d 1017 (2d Cir. 1976) the court cautioned that this precise language "should not be extended as a generalization in cases other than those involving labor collective bargaining agreements where the claim is that ... [a provision of the labor laws] ... precludes disaffirmance of the labor agreement in a Chapter XI proceeding without taking steps required under [the labor laws] ..." 543 F.2d at 1018-1019. In the Court of Appeals' decision below, it blithely ignored its own injunction.

tion, if a contract is executory under Section 70b of the Bankruptcy Act, and the trustee affirms it, "the trustee will have to accept the entire contract, including an arbitration clause if the contract contains one." (App. A, p. 8a n.7a.) The court below does not explain how the result can be any different with a fully executed contract where the bankrupt has had the full benefit of its contractual bargain before bankruptcy proceedings. The rationale of this Court's very recent holding in *Nolde Bros., Inc.* v. *Local No. 358, supra,* that the arbitration clause of a collective bargaining agreement survives the termination of the agreement, is persuasive precedent that such clauses should also survive bankruptcy proceedings.

Implicit in the Court of Appeals' decision is the view that arbitration is in some way disfavored under the Bankruptcy Act. The Court of Appeals argued that the "federal policy favoring arbitration" was not dispositive of this case, since there were "different, sometimes competing public policy interests" allegedly reflected in the Bankruptcy Act (App. A, p. 12a). But, the court cited no section of the Act and nothing in the Bankrutcy Act itself even remotely suggests that arbitration is in any way disfavored (much less prohibited) thereunder. Indeed, the Second Circuit itself has recognized that sections of the Bankruptcy Act "evince a receptivity to arbitration," *Fallick* v. *Kehr, supra,* 369 F.2d at 904,[23] and shortly prior to its decision in this case, reaffirmed that a contractual "obligation to arbitrate, solemnly undertaken, is not subject to a unilateral disavowal" by a trustee and

[23] *See also,* Rule 919(b) of the Bankruptcy Rules expressing this same receptivity to arbitral resolution of "*any* controversy affecting the estate."

"survives the filing of a petition in bankruptcy." *Truck Drivers Local Union No. 807* v. *Bohack Corp., supra,* 541 F.2d at 319-320.[24]

Thus, without any precedent or other basis for doing so, the Court of Appeals has ignored the rule that a trustee in bankruptcy can be compelled to submit to arbitration when he elects to sue alleged debtors of an estate in a plenary proceeding and has invested the Bankruptcy Act with a heretofor unrecognized "public policy" which is assertedly "competing" with the policy of the Arbitration Act. Because it makes no reference whatever to any section or language of the Bankruptcy Act to narrow its "public policy" observations, it has again created the potential for a vast multitude of suits in the District Courts arising under every section of the Bankruptcy Act which in the past would have been determined by arbitration. At the least, its decision will spawn substantial litigation as to the arbitrability of all disputes arising under the Bankruptcy Act.

[24] Bankruptcy Judge Babitt (the bankruptcy Judge presiding over Walston's bankruptcy) has held:

> ". . . the federal policy in favor of arbitration is part of the warp and woof of the fabric of our jurisprudence. . . . *And any doubt that the policy is clearly applicable in bankruptcy proceedings is dispelled,* not only by the plain agreement between the parties itself as here which the court recognizes, but also *by this court's awareness that arbitration may be an appropriate method for resolving controversies between trustees or debtors-in-possession and others. . . .*" (Citations omitted) (Emphasis supplied).

In the Matter of Blair & Co. (Cahn), No. 70 B 755 (S.D.N.Y. May 12, 1972), *aff'd,* by Brieant, J., Sept. 6, 1972; *accord, In the Matter of Blair & Co.,* (Danford), No. 70 B 755 (S.D.N.Y., June 1, 1973). (Both of these unreported opinions are printed at Appendix F.)

CONCLUSION

For the foregoing reasons, this petition should be granted and a writ of *certiorari* should be issued to review the decision below.

Respectfully submitted,

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April 25, 1977

APPENDIX

APPENDIX A

Opinion and Judgment of the Court of Appeals

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 257—September Term, 1976.

(Argued December 2, 1976 Decided January 25, 1977.)

Docket No. 76-7235

WINTHROP J. ALLEGAERT,
as Trustee of duPont Walston Incorporated,
Plaintiff-Appellant,

—against—

H. ROSS PEROT, ELECTRONIC DATA SYSTEMS CORPORATION, duPONT GLORE FORGAN INCORPORATED, WILLIAM K. GAYDEN, MORTON H. MEYERSON, MILLEDGE A. HART, III, MARGOT PEROT, MERVIN L. STAUFFER, PHM & Co., CHARLESTON INVESTMENT COMPANY, E. D. SYSTEMS CORPORATION, NEW YORK STOCK EXCHANGE, INC., DANIEL J. CULLEN, WILLIAM D. FLEMING, GEORGE T. THOMSON and CHARLES W. COX,
Defendants-Appellees,

—and—

DOUGLAS E. DETATA, JOHN J. DOUGHTY,
ALLAN BLAIR and D. TIPP CULLEN,
Defendants.

BEFORE:

MOORE, FEINBERG and GURFEIN,
Circuit Judges.

Appeal from orders of United States District Court for the Southern District of New York, Whitman Knapp, *J.*, granting stay pending arbitration of bankruptcy trustee's claims that defendants violated, inter alia, the Bankruptcy Act, the securities laws and state corporate laws.

Judgment reversed and case remanded.

GEORGE A. DAVIDSON, New York, N.Y. (Hughes Hubbard & Reed; Robert J. Sisk, Karen G. Lind, on the brief), *for Plaintiff-Appellant.*

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SAMUEL M. KOENIGSBERG, New York, N.Y. (Guggenheimer & Untermyer; Harold Baer, Jr., on the brief), *for Defendants-Appellees Daniel J. Cullen, William D. Fleming, Charles W. Cox, George T. Thomson.*

RUSSELL E. BROOKS, New York, N.Y. (Milbank, Tweed, Hadley & McCloy; Stephen Kowitt, on the brief), *for Defendant-Appellee New York Stock Exchange, Inc.*

WEIL, GOTSHAL & MANGES; PETER GRUENBERGER, JAMES W. QUINN, HENRY J. TASHMAN, New York, N.Y., *for Defendants-Appellees H. Ross Perot, Milledge A. Hart, III, Morton H. Meyerson, PHM & Co., duPont Glore Forgan Incorporated.*

LUCE HENNESSY SMITH & CASTLE; THOMAS W. LUCE, III, ROBERT POWELL, Dallas, Texas, *for Defendants-Appellees William K. Gayden, Marvin L. Stauffer, Charleston Investment Co., Margot Perot.*

FEINBERG, *Circuit Judge:*

This case raises significant questions regarding the interplay between the powers of a bankruptcy trustee and the United States Arbitration Act, 9 U.S.C. §§ 1-14. Winthrop J. Allegaert, bankruptcy trustee of duPont Walston Incorporated (Walston), appeals from two orders of the United States District Court for the Southern District of New York, Whitman, Knapp, *J.*, which stay the trustee's action against 20 defendants and, in effect, require the trustee to arbitrate his claims. The trustee's complaint states various causes of action under federal and state law arising out of the realignment in July 1973, at the alleged instance of H. Ross Perot, of the businesses of Walston and duPont Glore Forgan Incorporated (DGF Inc.), both then securities brokerage firms and members of the New York Stock Exchange, Inc. (NYSE) and the American Stock Exchange, Inc. (Amex). Defendants in the trustee's suit are Perot, DGF Inc., Electronic Data Systems Corporation (EDS), which is controlled by Perot, the NYSE, several Perot associates and investment vehicles, and the Walston directors who voted in favor of the realignment of Walston and DGF Inc. For reasons set forth below, we conclude that the district court erred in staying all causes of action in the trustee's suit. Therefore, we reverse the orders of the district court, vacate the stay and allow the trustee's suit to continue at least with respect to most of the causes of action stated in his complaint.

I

Background

To clarify the issues on appeal, it is necessary to state in some detail the facts as claimed by the trustee in his complaint or as they appear in the limited record before us. The trustee alleges a complex scheme to defraud Walston, under which defendants both siphoned off Walston's assets to DGF Inc. and also imposed the latter's liabilities on

Walston. According to the trustee, Perot was trying to get out of a disastrous involvement with the brokerage business and was the mastermind behind the scheme. Perot is the founder and controlling stockholder of EDS, which operates data processing systems for corporate customers. In the early 1970's, Perot invested about $70 million in, and took control of, the brokerage firm later known as DGF Inc. Perot had borrowed most of the money and had pledged EDS stock as collateral, but the value of that stock depended on continued income from EDS's contract with DGF Inc. By spring 1973, however, DGF Inc. was in bad shape; insufficient capital had brought it to the verge of liquidation. That event would have threatened Perot's entire financial empire and to avoid it, Perot came up with the scheme (the Perot Plan) that involved Walston, in which Perot was a minority investor.

The trustee describes the Perot Plan as a series of unusual transactions by which Walston would assume all front office operations of the two firms and DGF Inc. would assume back office operations. All of the liabilities of DGF Inc.'s failing branch office system would be shifted to Walston, including lease liabilities on many offices, some already closed. Walston would pay DGF Inc.'s expenses and make a $3 million advance on them. In addition, Perot would exchange his non-voting preferred stock in Walston for a new series of preferred stock with more voting rights than all of Walston's common stock. Thus, the Plan would protect DGF Inc.'s capital against future loss, while Walston would assume immense liabilities.

According to the trustee, the Perot Plan was railroaded through the Walston Board of Directors in July 1973 by a vote of 10-9, after insufficient notice of the lengthy and complex realignment agreements and at a Sunday Board meeting that lasted until the early hours of Monday morning, during which the Perot representatives made numerous misrepresentations and omissions of material information

and promises of improper benefits. The trustee also alleges that the NYSE, because of its own interest in preserving the capital of DGF Inc.,[1] concealed the conclusions of its own staff that Walston's capital would be completely depleted in eight months if the Perot Plan were adopted. After the Plan went into effect, Walston allegedly lost over $30 million and was forced to liquidate its business.

Court Proceedings

In March 1974, Walston filed a petition in the United States District Court for the Southern District of New York under Chapter XI of the Bankruptcy Act. Two months later, Bankruptcy Judge Roy Babitt adjudicated Walston a bankrupt and Allegaert was appointed trustee. The trustee asserts that before the realignment agreements went into effect, Walston had an equity of more than $30 million. At the time of bankruptcy it apparently had assets of less than $2 million and creditors' claims of over $75 million.

Based on this sorry picture,[2] the trustee brought suit in July 1975 against defendants, alleging violations of the Securities Act of 1933, the Securities Exchange Act of 1934, the Bankruptcy Act, the Delaware General Corporation Law, the New York Business Corporation Law, the New York General Business Law and the common law. In October 1975, most of the defendants moved under the United States Arbitration Act to stay the action pending

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[1] According to the trustee, the NYSE was interested in saving DGF Inc. because its liquidation would have made the Exchange Special Trust Fund liable to Perot on a $15 million note, and the Fund lacked funds sufficient to cover that amount.

[2] Appellees dispute the accuracy of the trustee's "facts," pointing out that many of them are mere allegations in a complaint and have not been proved. We, of course, express no view as to whether the trustee's allegations, particularly those charging fraud and wrongdoing, are correct.

arbitration of the claims alleged in the complaint.[3] These defendants relied upon three arbitration clauses, each of which was allegedly binding upon Walston and, therefore, upon its trustee. The first two were contained in the Constitution of the NYSE and the Amex and required arbitration of all controversies between exchange members and all controversies between a member and a nonmember who seeks arbitration of any claim arising out of the member's business.[4] The third arbitration clause appeared in one of the realignment agreements and covered all disputes arising out of those agreements.[5] Although the NYSE is not a

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[3] The nonmoving defendants are four former directors of Walston: Douglas E. DeTata, John J. Doughty, D. Tipp Cullen and Allan Blair.

[4] Article VIII, section 1 of the New York Stock Exchange Constitution provides:

> Any controversy between parties who are members, allied members, member firms or member corporations shall, at the instance of any such party, and any controversy between a non-member or allied member or member firm or member corporation arising out of the business of such member, allied member, member firm or member corporation, or the dissolution of a member firm or member corporation, shall, at the instance of such non-member, be submitted for arbitration, in accordance with the provisions of the Constitution and the rules of the Board of Directors.

Article VIII, Section 1 of the American Stock Exchange Constitution provides:

> Members, member firms, partners of member firms, member corporations and officers of member corporations shall arbitrate controversies arising in connection with their business between or among themselves or between them and their customers as required by any customer's agreement or, in the absence of a written agreement, if the customer chooses to arbitrate.

[5] Article 10.11 of the Master Agreement provides:

> ARBITRATION. duPont and Walston agreed to submit any dispute arising under this Agreement and the Ancillary Agreements or with respect to any of the transactions contemplated thereby to arbitration, in accordance with the provisions of

party to the agreements to arbitrate, it moved to stay the trustee's action on the ground that the arbitration between the trustee and the arbitrating defendants would resolve many of the issues affecting the NYSE and may render moot the action against it.

In April 1976, Judge Knapp granted the motion to stay. In a memorandum opinion,[6] he reasoned that the arbitration clauses were enforceable against the trustee and there was no persuasive reason not to do so. Although the NYSE could not compel arbitration, its arguments as to why the action against it should also be stayed were persuasive. This appeal followed.

II

The trustee's principal contentions before us are that he is not the same entity as the bankrupt, Walston, and is therefore not bound by the latter's executory arbitration contracts and that he cannot be compelled, in any event, to arbitrate the claims arising under the Bankruptcy Act and the securities laws. The trustee also claims that the arbitration agreements would not have been enforceable even against Walston. Finally, the trustee argues that even if he must arbitrate his claims against some defendants, the judge should not have stayed the action against the NYSE, which concededly has no right to compel arbitration of the trustee's dispute with it. Defendants respond that a bankruptcy trustee enjoys no special status which exempts him from the effect of arbitration clauses contained in non-

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> the Constitution of the NYSE and the Rules of the NYSE, except that disputes under the Clearing Agreement relating to transactions executed on an exchange other than on the NYSE, which has in its constitution or rules provisions compelling arbitration among members thereof, shall be submitted to arbitration in accordance with the Constitution and Rules of such other exchange.

[6] This was followed by a formal order and a brief supplemental memorandum.

executory contracts of the bankrupt, that the Bankruptcy Act and securities law claims are arbitrable, that the arbitration agreements were binding on Walston and the trustee, and that the district court acted properly in staying the action pending arbitration. Finally, defendants say that even if some of the trustee's claims are not arbitrable, his action upon them should be stayed pending arbitration of all the other issues.

These arguments obviously raise a number of substantial questions,[7] but we do not find it necessary to consider most of them. The trustee's position that he and the bankrupt are different legal entities is certainly correct. We said precisely that in *Shopmen's Local 455* v. *Kevin Steel Products, Inc.*, 519 F.2d 698, 704 (2d Cir. 1975), where we pointed out that a bankruptcy trustee is "[a] new entity . . . with its own rights and duties, subject to the supervision of the bankruptcy court." We again emphasized the point the following month in *Brotherhood of Railway Clerks* v. *REA Express, Inc.*, 523 F.2d 164, 167 (2d Cir.), cert. denied, 423 U.S. 1017, 1073 (1975, 1976). We recognize that the existence of this distinction between the bankrupt and the trustee is not necessarily dispositive. The significance of the distinction hinges on the facts of each situation.[7a] But the trustee's complaint shows the

[7] For example, if the parties have terminated or have fully performed under a contract, but have not arbitrated their dispute as the contract's arbitration clause provides, is the arbitration agreement an executory contract within the meaning of section 70b of the Bankruptcy Act and, therefore, rejectable by the trustee? See Countryman, Executory Contracts in Bankruptcy, Parts I and II, 57 Minn. L. Rev. 439 (1973), 58 Minn. L. Rev. 479 (1974). If not, are there instances in which a bankruptcy trustee is bound by an arbitration clause in an executed contract of the bankrupt?

[7a] For example, when the trustee affirms an executory contract under section 70b of the Bankruptcy Act, the difference is minimized; to obtain his rights under the contract the trustee will have

lack of identity to be particularly important here. Seven counts state claims under various sections of the Bankruptcy Act,[8] and charge that the realignment scheme resulted in fraudulent, preferential or post-bankruptcy transfers of Walston's assets to the Perot interests, which the Act allows the trustee to set aside or recover for the benefit of Walston's creditors. These are statutory causes of action belonging to the trustee, not to the bankrupt, and the trustee asserts them for the benefit of the bankrupt's creditors, whose rights the trustee enforces. For example, if there had been no federal bankruptcy proceeding and if a creditor had independently asserted a claim under N.Y. Debt & Cred. Law § 278 to set aside a fraudulent transfer of assets, the creditor would not have been subject to any arbitration agreement. Since the trustee stands in the creditor's shoes for this purpose, he too should not be compelled to arbitrate these claims. See also *Johnson* v. *England*, 356 F.2d 44, 51 (9th Cir.), cert. denied, 384 U.S. 961 (1966). Cf. *Buttrey* v. *Merrill Lynch, Pierce, Fenner & Smith*, 410 F.2d 135 (7th Cir. 1969).

Moreover, seven counts in the complaint allege, in effect, violations of various anti-fraud provisions of the securities laws.[9] In the context of this case neither these claims nor the Bankruptcy Act claims should be arbitrable. In *American Safety Equipment Corp.* v. *J. P. Maguire & Co.*,

to accept the entire contract, including an arbitration clause if the contract contains one. *Truck Drivers Local 807* v. *Bohack Corp.*, 541 F.2d 312 (2d Cir. 1976).

[8] Sections 60, 67 and 70.

[9] Three counts allege violations of § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5; one count rests on Section 29 (b) of the Exchange Act to void the realignment contract; one count charges violations of Section 17(a) of the Securities Act of 1933; one count is grounded in Section 12(2) of the Securities Act; and one count seeks to impose liability on controlling persons under Section 15 of the Securities Act and Section 20(a) of the Exchange Act.

391 F.2d 821, 825 (2d Cir. 1968), we analyzed at some length the considerations affecting whether a claim was "of a character inappropriate for enforcement by arbitration."[10] In holding that we would not there compel arbitration of private antitrust claims on the basis of an arbitration agreement made before the claim arose, we examined, among other things, the public interest in the dispute, the degree to which the nature of the evidence made the judicial forum preferable to arbitration and the extent to which the agreement to arbitrate was a product of free choice. At least the first two of these criteria cut sharply against arbitrability here. This is no mere dispute between private parties with public interest overtones, as in *American Safety*. We have here a claim by a trustee, appointed under the authority of a federal bankruptcy court, in connection with one of the most celebrated brokerage house failures in the history of Wall Street.[11] And the Bankruptcy Act claims are asserted on behalf of many hundreds of creditors. Unlike an operating business, the trustee employs no witnesses with knowledge of the relevant facts, and he has almost none of the relevant records. Under the Perot Plan, all "back-office" functions —accounting, record keeping, etc.—were performed by DGF Inc., which is now also defunct. Yet the availability of discovery in arbitration is uncertain.

The presence of the securities law claims further supports the need for a judicial tribunal here. In *Greater Continental Corp.* v. *Schechter*, 422 F.2d 1100, 1103 (2d Cir. 1970), we noted the "strong federal policy in favor of determining stock fraud questions in the federal courts" and observed:

[10] The quotation was from *Wilko* v. *Swan*, 201 F.2d 439, 444 (2d Cir.), rev'd, 346 U.S. 427 (1953).

[11] See C. Welles, *The Last Days of the Club* 258-66 (1975). See also Rustin, *Who Bailed Out Whom When Walston Joined With duPont Glore Forgan?*, Wall St. J., August 13 ,1973, at 1.

> This type of question concerning fraud within the meaning of Rule 10b-5 is properly litigated in the courts where a complete record is kept of the proceedings and findings and conclusions are made. It was for that reason that in both the 1933 and 1934 securities acts Congress provided that questions arising under those acts were not to be determined in arbitration proceedings (but rather in the courts) even if the contract between the parties contained an arbitration provision. Section 14 of the Securities Act of 1933, 15 U.S.C. § 77a, see *Wilko* v. *Swan*, 346 U.S. 427, 74 S. Ct. 182, 98 L. Ed. 168 (1953); section 29(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78cc. . . .

Id. It is true that we have recognized a limited exception to the policy behind *Wilko* v. *Swan* by allowing arbitration of disputes affecting member firms of stock exchanges. See e.g., *Coenen* v. *R. W. Pressprich & Co.*, 453 F.2d 1209 (2d Cir. 1972); *Axelrod & Co.* v. *Kordich, Victor & Neufeld*, 451 F.2d 838 (2d Cir. 1971). In *Coenen*, plaintiff NYSE member was required to arbitrate his claim against another member for conspiring to force plaintiff to sell stock at a price held unconscionably low by refusing to allow plaintiff to transfer the shares free of a legend stating that registration was required. In *Axelrod*, a NYSE member firm unsuccessfully resisted arbitration of a claim against it by a nonmember securities firm that charged breach of a stock purchase contract. We held that in these intramural situations the Congressional intent to let the stock exchanges regulate themselves, embodied in section 28(b) of the Exchange Act,[12] creates an exception to the *Wilko* rule.[13] But

[12] 15 U.S.C. § 78bb provides, in pertinent part:

> (b) nothing in this chapter shall be construed to modify existing law (1) with regard to the binding effect on any member of an exchange of any action taken by the authorities of such exchange to settle disputes between its members. . . .

[13] In *Coenen*, we also stressed that the agreement to arbitrate

the exceptions to the general rule for disputes between brokerage houses over industry matters make sense only when limited to their facts. A claim of wholesale fraud of institutional dimension, especially when raised by a trustee, does not fall within the rationale of the exception. This is more than a mere internal brokerage industry squabble; it raises broad questions of policy which ordinarily should be handled by the judiciary for reasons similar to those why an antitrust claim should not ordinarily be arbitrable. See *American Safety Equipment Corp.* v. *J. P. Maguire & Co.*, 391 F.2d 821, 825-29 (2d Cir. 1968). Cf. *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware*, 414 U.S. 117 (1973).

Citing *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506, 510 & n.4 (1974), and *Erving* v. *Virginia Squires Basketball Club*, 468 F.2d 1064, 1067-68 (2d Cir. 1972), appellees argue that the trustee's "shrill cry against arbitration" invites us to return to the discredited notions of a bygone era when courts resisted arbitration to the bitter end. We agree that such judicial hostility to the arbitration process is, and should remain, a thing of the past. We accept without reluctance the "federal policy favoring arbitration," *Carcich* v. *Rederi a/b Nordie*, 389 F.2d 692, 696 (2d Cir. 1968), reflected in the United States Arbitration Act. But such acceptance does not decide this case, which involves the equally significant policies reflected in the securities acts and the Bankruptcy Act. In such a situation, generalities must give way to careful analysis of the different, sometimes competing, public policy interests. Thus, none of the cases stressed so heavily by appellees controls the disposition here, since each depends on its own facts. In *Fallick* v. *Kehr*, 369 F.2d 899 (2d Cir. 1966), we allowed an arbitrator to decide in a dispute between private parties whether a debt had been discharged in a completed bankruptcy

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was made after the cause of action arose, thus distinguishing *American Safety*, and was therefore, "in effect an agreement to settle the dispute." 453 F.2d at 1215.

proceeding. We did so after careful consideration of all the factors involved, including Congressional lack of concern over use of a non-bankruptcy court forum to decide such issues.[14] In any event, we did not hold that *Kehr* could force *Fallick's* bankruptcy trustee to arbitrate that question. Similarly, in *Tobin* v. *Plein*, 301 F.2d 378 (2d Cir. 1962), and in *Truck Drivers Local 807* v. *Bohack Corp.*, 541 F.2d 312 (2d Cir. 1976), we did not force arbitration upon an unwilling bankruptcy trustee and the trustee was not asserting the type of claims made here under the securities laws and the Bankruptcy Act. The latter is also true of *Schilling* v. *Canadian Foreign Steamship Co., Ltd.*, 190 F. Supp. 462 (S.D.N.Y. 1961).

We conclude, therefore, that the trustee cannot be compelled to arbitrate his claims under the securities laws and the Bankruptcy Act. To that extent, the order of the district court staying the trustee's action was incorrect and should be reversed. The trustee should be allowed to pursue at least these causes of action immediately in the federal district court prior to any arbitration of the remaining claims. Cf. *American Safety*, supra, 391 F.2d at 828-29. Otherwise, the trustee's efforts to preserve the estate, of which this action is apparently the major asset, could be prejudiced by loss of evidence or witnesses, and by increased administrative expenses. Our decision, of course, means the trustee's action against the NYSE should go forward as well since there would then be no sufficient basis for staying it.[15] Finally, since the Bank-

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[14] We pointed out that, in order to avoid potential "abuse by unscrupulous creditors," Congress might want to amend the Bankruptcy Act. 369 F.2d at 905. Congress thereafter did so. 11 U.S.C. § 35(c) (1970).

[15] The NYSE argues that the order of the district court as to it is not appealable and should not be considered by us. This is technically true, but we note that in light of the result here, a refusal by the district court to reconsider and reverse its order would be an abuse of discretion.

ruptcy Act and securities law claims involve so many of the basic factual and legal issues underlying the trustee's remaining claims, resolution of the former may make it unnecessary or inappropriate to proceed with the latter in any forum. Under the circumstances, no arbitration should be permitted at this time.

Judgment reversed and case remanded for proceedings consistent with this opinion.[16]

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[16] On this disposition, we see no need to consider and resolve the other objections to arbitration raised by the trustee.

APPENDIX B

Opinion and Orders of the District Court

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

75 Civ. 3214

WINTHROP J. ALLEGAERT,
as Trustee of duPont Walston Incorporated,
Plaintiff,

—against—

H. ROSS PEROT, ELECTRONIC DATA SYSTEMS CORPORATION, duPONT GLORE FORGAN INCORPORATED, WILLIAM K. GAYDEN, MORTON H. MEYERSON, MILLEDGE A. HART, III, MARGOT PEROT, MERVIN L. STAUFFER, PHM & Co., CHARLESTON INVESTMENT COMPANY, E. D. SYSTEMS CORPORATION, NEW YORK STOCK EXCHANGE, INC., DANIEL J. CULLEN, WILLIAM D. FLEMING, GEORGE T. THOMSON and CHARLES W. COX, DOUGLAS E. DeTATA, JOHN J. DOUGHTY, ALLAN BLAIR, and D. TIPP CULLEN,
Defendants.

Memorandum and Order

(Microfilm April 15, 1976)

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KNAPP, D.J.

Sixteen of the twenty defendants[1] (hereinafter referred to as the "Perot" group) in this complex securities action growing out of the bankruptcy of the securities brokerage firm of duPont Walston Inc. ("Walston") have moved pursuant to the federal Arbitration Act (9 U.S.C. § 3) for an order staying all proceedings herein pending arbitration as allegedly required by the constitutions of the New York and American Stock Exchanges and other agreements between the parties. The defendant New York Stock Exchange has also moved to stay the action as to it and to compel arbitration. The plaintiff trustee in bankruptcy opposes these motions on a number of grounds, none of which are persuasive and the motions are, accordingly, granted.

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[1] The only defendants who have not joined in this motion are Douglas DeTata, John Doughty, Allan Blair and D. Tipp Cullen.

Factual Background

This action was commenced on July 1, 1975 by the Trustee [2] against 20 defendants, including 14 individuals, 5 corporations (including the New York Stock Exchange) and 1 partnership, asserting claims under federal and state securities laws, state statutory and common laws, and the federal bankruptcy statute. All of these claims arise out of and result from the July 2, 1973 realignment of the businesses of Walston and defendant duPont Glore Forgan Inc. ("DGF"), both of whom were member corporations of the New York and American Stock Exchanges ("NYSE" and "Amex", respectively). The realignment—whereby Walston assumed all front office operations of the two firms and DGF assumed all of the back office functions—was effected by means of a series of Realignment Agreements, instigated by the defendant H. Ross Perot, who had invested heavily in DGF and was a minority shareholder in Walston. The remaining defendants in this action are: PHM & Co., which owns the majority of the stock of DGF; the following partners of PHM & Co.: Milledge A. Hart, III and Morton H. Meyerson; the following directors of Walston who voted for the realignment: Daniel J. Cullen, William D. Fleming, George T. Thomson, Charles W. Cox, Douglas E. DeTata, John J. Doughty, Allan Blair; D. T. Cullen, William K. Gayden and Mervin L. Stauffer; Charleston Investment Co., which had a $15 million investment in Walston; Margot Perot, who owned the common stock of Charleston; Electronic Data Systems Corp., a computer company owned by Perot which had a data processing contract with DGF; E. D. Systems Corp., a subsidiary of Electronic Data Systems, which had a data processing contract with Walston; and the NYSE, of which Walston and DGF were member corporations—as were most of the other defendants as well—and which approved the realignment.

[2] Walston was declared a bankrupt on May 29, 1974.

The essence of the complaint can be distilled into three categories of claims against these defendants: a) that they conspired to mislead Walston into approving the realignment transaction and executing the Realignment Agreements; b) that DGF breached said Agreements; and c) that certain defendants misappropriated Walston's assets in effectuating the realignment, leading to Walston's financial collapse and eventual demise. The Trustee seeks compensatory damages of not less than $45 million, as well as punitive damages against certain of the defendants.

By the present motion, the Perot defendants seek to compel the Trustee to arbitrate his claims against them in the first instance. They point to three sources upon which they assert a right to arbitrate:

(1) Two separate provisions in the NYSE and Amex constitutions, both of which mandate arbitration of controversies between present and former members or allied members—Walston and 12 of the defendants so qualify (NYSE Constitution, Art. VIII, § 1; Amex Constitution, Art. VIII, § 1).

(2) The NYSE constitution provision granting the defendants who are non-members the right to compel Walston to arbitrate all claims against them rising out of the business or dissolution of Walston—7 defendants qualify under this provision (NYSE Constitution, Article VIII, Section 1).

(3) The additional arbitration clause in the Realignment Agreements requiring arbitration of disputes involving the Realignment Agreements or the transaction contemplated by the Realignment Agreements (Article 10.11 of Master Agreement to Realignment Agreements).

The NYSE itself, although concededly not entitled as of right to compel arbitration of the claims against it, also

seeks to stay the action as to it on the grounds that an arbitration would resolve many of the issues in the action and may even render it moot, and that failure to stay the action as to it would result in duplicative effort and create the possibility of inconsistent results.

The Trustee opposes the Perot motion to compel arbitration on essentially four grounds:

I. Having rejected all contracts containing arbitration clauses pursuant to § 70(b) of the Bankruptcy Act, the Trustee is relieved of any duty to arbitrate.

II. The arbitration clauses in the Exchange constitutions and the Master Agreement are unenforceable.

III. A stay cannot be granted because the complaint contains numerous non-arbitrable claims under the federal securities and bankruptcy laws.

IV. Any right to arbitrate has been waived.

With respect to the NYSE motion, the Trustee argues that the Exchange has not made the requisite showing of hardship or inequity and that a stay would severely prejudice the estate.

Because of the multiplicity of grounds alleged, this opinion will treat each separately, in the order mentioned above.

PEROT MOTION

I. Whether the Trustee's rejection of all executory Walston contracts pursuant to § 70(b) of the Bankruptcy Act relieves it of any duty to arbitrate enunciated therein.

The constitutions of both the NYSE[3] and the Amex[4] contain explicit provisions mandating arbitration of any

[3] Article VIII, Section 1 of the NYSE Constitution provides: "*Any controversy between* parties who are *members, allied*

and all controversies between parties who are members, allied members, member firms and member corporations arising out of their business if any party should so elect. Exchange members automatically become bound by these provisions—incorporated in the respective constitutions pursuant to the self-regulatory duties imposed upon the exchanges by § 6 of the 1934 Act—upon entering into stock exchange membership. The cases are unanimous in holding that NYSE and Amex members, member corporations and allied members are bound by the arbitration provisions, regardless of the subject matter or source of the dispute. *Coenen* v. *R. W. Pressprich & Co., Inc.* (2d Cir. 1972) 453 F.2d 1209, 1211; *In Re Revenue Properties Litigation Cases* (1st Cir. 1971) 451 F.2d 310, 313, *Legg, Mason & Company* v. *Mackall & Coe, Inc.* (D. D.C. 1972) 351 F. Supp. 1367, 1371, *Isaacson* v. *Hayden, Stone, Inc.* (S.D. N.Y. 1970) 319 F.Supp. 929, 930, *Brown* v. *Gilligan, Will & Co.* (S.D. N.Y. 1968) 287 F. Supp. 766, 769-70. See also, *Ghiron* v. *Mayer* (1st Dept. 1963) 241 N.Y.S. 2d 144, 19 App. Div. 2d 54, *Osborne & Thurlow* v. *Hirsch & Co.* (Sup. Ct. N.Y. Co. 1958) 172 N.Y.S. 2d 522, 10 Misc. 2d 225. *Accord,* two unreported decisions involving DGF Inc. and the

members, member firms or *member corporations shall,* at the instance of any such party, and any controversy between a non-member and a member or allied member or member firm or member corporation arising out of the business of such member, allied member, member firm or member corporation, or the dissolution of a member firm or member corporation, shall, at the instance of such non-member, *be submitted for arbitration,* in accordance with the provisions of the constitution and the rules of the Board of Directors." (Emphasis supplied)

[4] Article VIII, Section 1 of the Amex Constitution provides:

"Members, member firms, partners of member firms, member corporations and officers of member corporations shall arbitrate *all controversies* arising in connection with their business between or among themselves or between them and their customers as required by any customer's agreement or, in the absence of a written agreement, if the customer chooses to arbitrate." (Emphasis supplied)

very same arbitration provisions, *Hirsch* v. *F. I. duPont, Glore Forgan & Co.*, Index No. 11514/72 (Sup. Ct. N.Y. Co. 2/1/74) and *Fraiman* v. *F. I. duPont, Glore Forgan & Co.*, Index No. 23712/72 (Sup. Ct. N.Y. Co. 3/15/73). The rationale for this rule is that § 6 of the 1934 Act, 15 U.S.C. § 78f "gave securities exchanges extensive powers of self-regulation, imposing the responsibility for enforcement of the rules upon the exchanges themselves". *Legg, Mason & Co., Inc.* v. *Mackall & Coe, Inc.* (D. D.C. 1972) 351 F.Supp. 1367, 1371. Furthermore, as noted by the Second Circuit in *Coenen, supra,* at 1212,

> "The purpose behind the drafting of such a broad arbitration clause was, as much as possible, to keep disputes between members out of the courts".

In addition to the constitutional provisions discussed above, the Realignment Agreements—which are central to all of the Trustee's claims—contain an express arbitration clause providing for the arbitration of any and all disputes arising under the Agreements.[5]

Notwithstanding the existence of these three arbitration clauses, nor their concededly general applicability to the parties at hand,[6] plaintiff nevertheless contends that he is

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[5] Article 10.11 of the Master Agreement provides as follows:

"Arbitration. duPont and Walston agreed to submit any dispute arising under this Agreement and the Ancillary Agreements [which together are the Realignment Agreements] or with respect to any of the transactions contemplated thereby to arbitration, in accordance with the provisions of the Constitution of the NYSE and the Rules of the NYSE, except that disputes under the Clearing Agreement relating to transactions executed on an exchange other than on the NYSE, which has in its constitution or rules provisions compelling arbitration among members thereof, shall be submitted to arbitration in accordance with the Constitution and Rules of such other exchange."

[6] During the period covered by the complaint herein:

(a) Walston was a member corporation of both the NYSE and the Amex;

relieved of any duty to arbitrate by virtue of his special status as a trustee in bankruptcy. More specifically, under the power conferred on him by § 70[b] of the Bankruptcy Act, 11 U.S.C. § 110(b), to reject executory contracts of the bankrupt, the Trustee claims to have rejected all of the Walston "contracts" on which the defendants rely, thereby relieving himself of any duty to arbitrate defined therein. The weakness in such a position is that it rests on a false assumption: namely, that the various arbitration clauses constitute "executory contracts". Under none of these contracts was there any benefit or asset left for the Trustee to relinquish, nor any performance left to be completed, at the time of the bankrupt's adjudication. On March 11, 1974—16 days prior to filing its petition under Chapter XI and 79 days prior to its adjudication as a bankrupt—Walston gave notice to the NYSE and Amex that it was terminating its memberships. By May, 1974—

(b) DGF Inc. was a member corporation of both the NYSE and the Amex;

(c) Defendants Meyerson, D. J. Cullen, Fleming, Thomson, Cox, DeTata, Doughty, Blair and D. T. Cullen were allied members of both the NYSE and the Amex;

(d) Defendant Hart was an allied member of the NYSE; and

(e) Defendant Stauffer was an allied member of the Amex.

The 7 non-member defendants (PHM & Co., H. Ross Perot, William Gayden, Margot Perot, Electronic Data Systems Corp., E. D. Systems Corp. and Charleston Investment Co.) are also entitled at their election pursuant to Article VIII of the NYSE constitution to compel arbitration by virtue of the fact that the complaint herein states a "controversy between a non-member and a member corporation [Walston] . . . arising out of the business of such . . . member corporation . . ." *Axelrod & Co.* v. *Kordich, Victor & Neufeld* (2d Cir. 1971) 451 F.2d 838, 841.

Nor does termination of an exchange membership end the duty to arbitrate controversies predicated upon business relationships between parties who were exchange members at the time the obligation was created. *Isaacson* v. *Hayden Stone, Inc.* (S.D.N.Y. 1970) 319 F.Supp. 929.

the time of its adjudication—Walston had ceased doing any business under the rules of any exchange. Accordingly, under the "contracts" contained in the NYSE and Amex constitutions, there was no benefit or asset left for Walston or the Trustee to assume or reject, and no performance *in futuro* was required or expected of Walston or the Trustee. Once a contract has either been terminated or materially breached prior to adjudication in bankruptcy, the contract ceases to be executory for purposes of Section 70b. *Tobin* v. *Plein* (2d Cir. 1962) 301 F.2d 378, 381; *Crittenden* v. *Lines* (9th Cir. 1964) 327 F.2d 537, 542-543. Nor can the inclusion in an otherwise nonexecutory contract of an agreement to arbitrate that extends into the future render such contract executory. *Id.* An agreement to arbitrate does not create an obligation to perform *in futuro,* but rather, constitutes merely an acknowledgment that should one elect to sue, one consents to confine the dispute to a particular forum or form of proceeding.[7]

The same considerations apply with equal force to the arbitration clause in the Realignment Agreements, which by their own terms are written memoranda of a sequence of events and agreements already completed. Walston no longer had any obligation to perform *in futuro* thereunder, particularly in light of the fact that its entire business had disappeared long before adjudication. More importantly, the Trustee has in point of fact not rejected said Agreements; witness Counts XV and XVI of the complaint, which seek recovery on DGF's alleged failure to perform its obligations under the Agreements.

The cases cited by the Trustee in support of his position that he has the power to reject contracts requiring arbitration are inapposite, for they all involved contracts which were concededly executory. Equally significant is

[7] Despite the non-executory nature of the contracts here involved, the duty to arbitrate survives their completion, termination or breach. *Isaacson* v. *Hayden Stone, Inc , supra,* at 930.

the fact that in each instance, a creditor was seeking to enforce rights *against* a bankrupt's estate through arbitration, and thereby creating the potential of a distribution preference as against other creditors—a situation which the courts are understandably anxious to avoid. The underlying rationale of each court's decision to ignore the arbitration clause was that exclusive jurisdiction over claims *against* the bankrupt—not *by* the bankrupt, as in the instant case—must lie in one forum—the bankruptcy court—in order to assure the statutory goal of non-preferential distribution to all of the bankrupt's valid creditors. Thus, in those instances where the trustee in bankruptcy has been a plaintiff rather than a defendant, the courts have held that arbitration is appropriate. *Tobin* v. *Plein, supra, Schilling* v. *Canadian Foreign Steamship Co.* (S.D. N.Y. 1961) 190 F.Supp. 462. This is consistent with the "overriding federal policy favoring arbitration" [*Carcich* v. *Rederei, a/b Nordie* (2d Cir. 1968) 389 F.2d 692, 696] not simply in general commercial litigation, but in bankruptcy matters as well. *Fallick* v. *Kehr* (2d Cir. 1966) 369 F.2d 899, 903-4; General Order in Bankruptcy 33, *In the Matter of Blair & Co.* (Cahn), 70 B 755 (S.D.N.Y. 5/12/72) (Babitt, J. at p. 5), *aff'd,* by Brieant, J., 9/6/72.

II. Whether the Three Arbitration Provisions are Enforceable

A. *Disqualification of Forums*

The Trustee seeks to avoid enforcement of the 3 arbitration clauses on the alternative ground that the specific forums selected—the NYSE and the Amex, respectively —are disqualified to serve as forums by reason of their alleged involvement with the instant case. The NYSE is a named defendant, charged with making false statements of material fact in violation of § 10b of the 1934 Act and of knowingly permitting a fraudulent scheme to be imposed upon Walston in violation of its self-regulatory duties

under § 6 of the 1934 Act. Since the defendants have agreed that, under such circumstances, any arbitration in this case "should not be held under NYSE auspices",[8] in order to "avoid even the appearance of bias",[9] we shall not discuss the matter further except to say that we concur.

Unlike the NYSE, however, Amex has not been named as a party defendant. Nevertheless, the Trustee somewhat belatedly argues that the Amex would be in an "awkward" position if it were to hear and decide the claims in this case, since it too reviewed and approved the subject Realignment Agreements. The Trustee's failure to sue the Amex undermines this argument; if he genuinely thought or even suspected that he had a claim against the Amex, he would be derelict in his duty and potentially liable on his bond not to name it as a party defendant. Consequently, the Court is not persuaded by this belated claim of bias. *Klebanow* v. *Ira Haupt & Co.* (Sup. Ct., N.Y. Co. 1964) (Index No. 1105/64) (unreported). Even if we were, however, Article VIII, Section 2(c) of the Amex constitution provides for the alternative forum of the American Arbitration Association, as to which neither party can make any claims of bias.[10] Moreover, in light of the mandatory language of Section 5 of the Arbitration Act, 9 U.S.C. § 5,[11] empowering the court to itself appoint an

[8] See Memorandum in Support of defendants' Motion for Stay of Action Pending Required Arbitration, p. 18.

[9] *Commonwealth Coatings Corp.* v. *Continental Casualty* (1968) 393 U.S. 145, 150.

[10] Furthermore, this provision for an alternative forum belies the Trustee's unsupported contention that the identity of the original arbitration tribunal (NYSE or Amex) was so central to the agreement to arbitrate that its unavailability destroys the obligation to arbitrate in its entirety.

[11] ". . . upon the application of either party to the controversy the court *shall* designate and appoint an arbitrator . . . who shall act under the said agreement with the same force and effect as if he or they had been specifically named therein. . . ." (emphasis supplied)

arbitrator, federal courts have consistently held that arbitration should not be denied "on the ground of impossibility of following the procedure for designating the arbitrator". *Hawaii Teamsters and Workers, Local 996* v. *Honolulu Rapid Transit Co.* (D. Hawaii, 1972) 343 F.Supp. 419, 425. See also *Bethlehem Mines Corp.* v. *United Mine Workers of America* (3d Cir. 1974) 494 F.2d 723, *Erving* v. *Virginia Squires Basketball Club* (2d Cir. 1972) 468 F.2d 1064, 1067-8.

B. Arbitration Clause in Master Agreement was never agreed to by Walston

The Trustee lists four reasons (all of which are also alleged in the complaint) why, in his opinion, Walston never agreed to the terms of the Realignment Agreements, including the arbitration clause. The truth or falsity of these claims—which are essentially of fraud in the inducement of the contract rather than of the arbitration clause—is a question to be resolved by the arbitrator, not the Court. *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.* (1967) 388 U.S. 395, 403; *Robert Lawrence Co.* v. *Devonshire Fabrics, Inc.* (2d Cir. 1959) 271 F.2d 402, *cert. granted,* 362 U.S. 909, *dism'd under R.60,* 364 U.S. 801.

Recognizing this rule of law, the Trustee mounts a second and more specific attack by also claiming fraud in the inducement of the arbitration clause itself (which claim would ordinarily be cognizable in a judicial forum), in that had Walston known in advance of the NYSE's alleged financial interest in the salvage of DGF, it would never have agreed to arbitrate disputes arising out of the realignment in the forum of the NYSE. This argument, however, misses the mark, for the arbitration clause in question does not designate the NYSE as the exclusive

forum for arbitration. Even a cursory reading of §10.11 [12] reveals that the parties intended not to limit arbitration to the NYSE, but rather to arbitrate *all* of their disputes regardless of the forum. Thus, there is a reference therein to possible arbitration on national securities exchanges other than the NYSE.

III. Whether the various claims in the complaint are arbitrable

A. *Bankruptcy Act Claims*

The Trustee's contention that he cannot be required to arbitrate the six counts in his complaint which seek pursuant to § 70[e] to recover fraudulent transfers and the one count which seeks, pursuant to § 60[b], to recover voidable preferences is unsupported by the cases [13] or considerations of public policy. We agree with the defendants that he has confused a statutorily created *right*—namely the right of a trustee to realize assets for the estate—with the issue of the *forum* in which those rights are to be asserted. Simply because he has the power to recover fraudulent transfers and voidable preferences does not mean that he can bar the defendants' right to compel arbitration. It is the rule in this Circuit that a trustee in bankruptcy can be compelled to arbitrate claims. See, *e.g., Tobin* v. *Plein* (1962) 301 F.2d 378; *Schilling* v. *Canadian Foreign S.S. Co.* (S.D.N.Y. 1961) 190 F.Supp. 462. As Judge Feinberg noted in *Fallick* v. *Kehr* (2d Cir. 1966) 369 F.2d 899, 904, there is "nothing in the [Bankruptcy] Act that grants the bankrupt an absolute right to a choice of forum . . ." Indeed, the Act itself has a section dealing with arbitra-

[12] See n. 5, above.

[13] The cases cited by the Trustee are inapposite, for they all arose under a specific statutory scheme expressing an absolute and unqualified right to have rights arising thereunder adjudicated exclusively by a court of law. No such policy is evidenced in the Bankruptcy Act and the law in this Circuit concerning bankruptcy matters is to the contrary.

tion of controversies "arising in the settlement of the estate", 11 U.S.C. § 49, which, as the Court noted, "evinces a receptivity to arbitration". *Id.* Moreover, the provision in the NYSE constitution for the arbitration of controversies arising out of the "dissolution" of a member corporation is a clear indication of an express intent to arbitrate questions which might arise under the Bankruptcy Act.

The only argument the Trustee can muster in support of his rather vague contention that arbitration would be counter to "public policy" is his fear that somehow an arbitration tribunal would be "friendly" to the defendants. There is no evidence in the record to substantiate such a fear and the Second Circuit rejected this very argument in *Fallick,* at 904.

B. *Securities Laws Claims*

In an effort to avoid this rule in this Circuit—first announced in *Brown* v. *Gilligan, Will & Co.* (S.D.N.Y. 1968) 287 F.Supp. 766—that arbitration of securities laws claims is appropriate in suits against stock exchange members, the Trustee urges us to apply instead the rule first announced in *Wilko* v. *Swan* (1953) 346 U.S. 427 that customers and investors may not be compelled to arbitrate such claims. This we decline to do, in the fact of the strong authority in this Circuit to the contrary [14] and the policy considerations underlying the distinction between broker-dealers on the one hand and investors and customers on the other. As Judge Cooper concluded in *Brown, supra,* the Congressional intent to encourage stock exchange "self-regulation" of the business conduct of its broker-

[14] See also *Coenen* v. *R. W. Pressprich & Co., Inc., supra; Axelrod & Co.* v. *Kordich, Victor & Neufeld, supra; Rust* v. *Drexel Firestone Inc.* (S.D.N.Y. 1972) 352 F.Supp. 715; *Legg, Mason & Co.* v. *Mackall & Coe, Inc., supra; Reich & Co.* v. *Imperial Investment Corp.* (S.D.N.Y. 1972) CCH Fed. Sec. Rep. ¶ 93,437 (not officially reported).

dealers justifies arbitration of securities law disputes between exchange members. Unlike suits involving customers, there is no statutory anti-waiver provision [15 U.S.C. § 78cc(a)] rendering void agreements to arbitrate between broker-dealers. Whereas the 1933 and 1934 Acts were specfically intended to protect investors, any protection afforded to broker-dealers is merely incidental. *Brown* v. *Gilligan, Will & Co., supra,* at 771-2. One of the primary policy justifications reflected in the *Wilko* rule voiding arbitration agreements binding customers was to prevent a broker-dealer from taking advantage of the inferior bargaining position of its customers. Such a consideration is absent when arbitration is sought, as here, *against* a broker-dealer pursuant to an exchange rule. *Axelrod & Co.* v. *Kordich, Victor & Neufeld, supra.* Moreover, whereas the *Wilko* rule derives from two statutory non-waiver provisions—15 U.S.C. §§ 77n and 78cc(a)—the *Brown* rule favoring arbitration as between exchange members derives from a specific statutory exception to the non-waiver provisions, § 28b of the 1934 Act, 15 U.S.C. § 78bb(b). *Brown* v. *Gilligan, Will & Co., supra,* at 774-5. Finally, the Trustee's argument that the policies requiring an exchange member to submit to arbitration are inapplicable where the party resisting arbitration has resigned its membership or is in bankruptcy is specifically contradicted by the cases compelling former exchange members to submit to arbitration. *Isaacson* v. *Hayden Stone, Inc., supra,* at 930; *Osborne & Thurlow* v. *Hirsch & Co., supra; Cf., Ayres* v. *Merrill, Lynch, Pierce, Fenner & Smith, Inc.* (E.D. Pa. 1973) 353 F.Supp. 1084.

IV. Whether the defendants have waived their right to arbitrate

In January 1974, Nella A. Walston, a major shareholder of Walston and the widow of Walston's founder, commenced a shareholder's derivative action in New York

Supreme Court against 16 [15] of the 20 defendants named in the present case (*Walston* v. *duPont Glore Forgan*, Index No. 625/74). The complaint, which is only 10 paragraphs long, seeks equitable relief only for alleged violations of state corporate fiduciary laws. Nowhere does it mention the many violations of state and federal securities laws, federal bankruptcy laws and state statutory and common law upon which the instant complaint seeking damages is based, although it does question the basic fairness of the realignment, as does the instant complaint. All of the defendants named in the state action answered on the merits, and four of them filed third-party counterclaims on grounds different from the issues raised either in the instant action or the Walston complaint. During the eleven month period prior to suspension of discovery in the state action in December, 1974, the defendants never sought arbitration.

On the basis of the foregoing, the Trustee contends that the present movants have waived whatever right to arbitration they may have had. In order to establish a waiver—a finding which is not lightly made in view of the overriding federal policy favoring arbitration [16]—the party opposing arbitration must show (a) undue delay by the party seeking arbitration, plus (b) inconsistent action by the latter resulting in (c) substantial prejudice to the former. *Weight Watchers of Quebec, Ltd.* v. *Weight Watchers International, Inc.* (E.D.N.Y. 1975) 398 F.Supp. 1057, 1059, and cases there cited, at n.5. Plaintiff's failure to establish any one, much less all, of these tests precludes a finding of waiver. The moving defendants have sought to arbitrate here at the earliest available opportunity: at the time they were required to answer or move against the complaint.[17] There has been no discovery to date and

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[15] Eleven of whom are movants herein.

[16] *Carcich* v. *Rederei A/B Nordie, supra,* at 696.

[17] Several stipulations extending the defendants' time to answer

no motion practice other than the instant motions to stay the proceeding and compel arbitration. Plaintiff has made no effort to show any resultant prejudice, let alone "substantial" prejudice from the failure of some of the defendants to demand arbitration in the state court proceeding. Nor can the failure to demand arbitration in the state case be imputed to the defendants herein, for even extensive participation *in the same case,* absent a clear showing of substantial prejudice, will not be deemed a waiver. *Carcich* v. *Rederei A/B Nordie, supra,* at 696.[18] No dis-

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or move were entered into by counsel, but they do not rise to the level of a waiver. *Macchiavelli* v. *Shearson Hammill & Co., Inc.* (E.D. Calif. 1974) 384 F.Supp. 21, 26.

[18] As the court there observed,

"Yet the law is clear that such participation, standing alone, does not constitute a waiver, *Chatham Shipping Co.* v. *Fertex Steamship Corp.,* 352 F.2d 291, 293 (2d Cir. 1965) (filing complaint not waiver); *Reynolds Jamaica Mines, Ltd.* v. *La Societe Navale Caennaise,* 239 F.2d 689 (4th Cir. 1956) (asserting counterclaim not waiver); *Rootes Motors, Inc.* v. *SS Carina,* 1964 A.M.C. 2754 (S.D.N.Y. 1964) (filing answer without mentioning arbitration not waiver), for *there is an overriding federal policy favoring arbitration. Waiver, therefore, is not to be lightly inferred,* and mere delay in seeking a stay of the proceedings without some resultant prejudice to a party, *Kulukundis, supra,* cannot carry the day." (emphasis supplied and footnotes omitted)

The court in *Hiltie, Inc.* v. *Oldach* (1st Cir. 1968) 392 F.2d 368, relying on the identical rule, recited numerous examples of extensive participation in cases where claims of waiver were rejected:

"The cases demonstrate with marked consistency the reluctance of courts to find default despite substantial delay and intervening proceedings. *Robert Lawrence Co.* v. *Devonshire Fabrics, Inc.* (2d Cir. 1959) 271 F.2d 402, *cert. granted,* 362 U.S. 909, *dismissed under Rule 60,* 364 U.S. 801 (1960) (9 month delay; interim settlement discussions; disputed goods tested; *held* no default); *Almacenes Fernandez, S.A.* v. *Golodetz* (2d Cir. 1945) 148 F.2d 625 (6 month delay; 7 third party defendants joined; *held:* no default); *Kulukundis Shipping Co.* v. *Amtorg Trading Corp.* (2d Cir. 1942) 126 F.2d 978 (9 month delay; answer amended two months before trial to assert right to arbitration; 'no important intervening steps

covery was taken in the state case by or addressed to the defendants in that case who are the moving parties on this motion. The merits of that case were never litigated and the case has been dormant for over one and one-half years.

Given the above circumstances, we decline to find that the movants have waived their right to arbitration.

NYSE Motion

Although the NYSE is admittedly not a party to the three arbitration agreements successfully invoked by the Perot group, it nevertheless has persuaded us that the action as to it must be stayed as well so as to avoid duplicative effort, the possibility of inconsistent results and the potential for unnecessary waste of the estate's limited assets. If the Exchange is correct that the arbitration will resolve many of the issues raised by this action, proceeding with the action while arbitration is pending would constitute waste of the estate and of judicial time as well. On the other hand, if the Exchange is wrong in that regard, nothing will have been lost. In the event that the passage of time under a stay might prejudice the estate—as in the loss of evidence—the Court could, upon a proper showing of necessity, condition its stay to permit selective discovery to go forward.[19]

. . . taken'; *held:* no default); *Lumbermen's Mut. Cas. Co.* v. *Borden Co.* (S.D.N.Y. 1967) 268 F.Supp. 303 (motion for stay of proceedings delayed two years; no direct dispute between plaintiff and movant until some 21 months after suit initiated; answer never filed; discovery initiated by plaintiff; *held:* no default)." (392 F.2d at 372, fn. 9).

[19] Indeed, such a procedure has already been adapted in the case with respect to an elderly and sick non-party witness residing in Florida.

CONCLUSION

The motion for a stay and to compel arbitration, filed by the Perot group is granted. So as to avoid even the appearance of bias which designation of the Amex might engender, the parties are directed to agree among themselves upon the appropriate arbitration tribunal, in default of which, the Court will, in accordance with the spirit of the Amex constitution, designate the American Arbitration Association. The motion of the NYSE to stay the proceeding as to it pending arbitration is also granted. In the exercise of the Court's inherent power to control its own docket, the action is stayed as to the four non-moving defendants as well.

Settle order on notice.

So ORDERED.

Dated: New York, New York
April 12, 1976.

/s/ Whitman Knapp
WHITMAN KNAPP, U.S.D.J.

75 Civ. 3214

CAPTION OMITTED IN PRINTING

(FILED MAY 6, 1976)

Counter-Order

A motion having been made by the defendants H. Ross Perot, Electronic Data Systems Corporation, duPont Glore Forgan Incorporated, William K. Gayden, Morton H. Meyerson, Milledge A. Hart, III, Margot Perot, Mervin L. Stauffer, PHM & Co., Charleston Investment Company, E. D. Systems Corporation, Daniel J. Cullen, William D. Fleming, George T. Thomson and Charles W. Cox, for an order pursuant to 9 U.S.C. § 3 staying the trial of the action until arbitration of the claims asserted against them in the action has been had, and a motion having been made by the defendant New York Stock Exchange, Inc. (the "Exchange"), for an order pursuant to the inherent powers of the court to control its docket that the trial of the action be stayed as to it until arbitration of the claims asserted against the above moving defendants has been had; briefs and affidavits having been exchanged and filed; oral argument having been had; the Court having duly deliberated and having issued its opinion and order filed April 14, 1976:

It is hereby ORDERED as follows:

1. The motion of the defendants H. Ross Perot, Electronic Data Systems Corporation, duPont Glore Forgan Incorporated, William K. Gayden, Morton H. Meyerson, Milledge A. Hart, III, Margot Perot, Mervin L. Stauffer, PHM & Co., Charleston Investment Company, E. D. Systems Corporation, Daniel J. Cullen, William D. Fleming, George T. Thomson and Charles W. Cox that the trial of this action be stayed until arbitration of the claims asserted against them has been had is granted, provided,

however, that plaintiff may apply to the court for permission to use the pretrial discovery procedures of the Federal Rules of Civil Procedure where circumstances warrant.

2. The motion of the Exchange that the trial of this action be stayed as to it pending any arbitration of the claims asserted in this action is granted, provided, however, that plaintiff may apply to the court for permission to use the pretrial discovery procedures of the Federal Rules of Civil Procedure where circumstances warrant.

3. In the exercise of the Court's discretion and inherent power to control its own docket, the trial of this action is stayed as to the defendants Douglas E. DeTata, John J. Doughty, Allan Blair and D. Tipp Cullen pending arbitration as aforesaid.

4. The parties are directed to agree among themselves upon the appropriate tribunal, in default of which the Court will designate the American Arbitration Association as the arbitration tribunal.

Dated: New York, New York
April 30, 1976.

/s/ WHITMAN KNAPP
U.S.D.J.

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75 Civ. 3214

CAPTION OMITTED IN PRINTING

(FILED MAY 14, 1976)

Memorandum and Order

KNAPP, D.J.

The Court has signed the Order submitted by plaintiff. In so doing it necessarily overruled the objections noted in defense counsel's letter of April 30, 1976. The Court wishes to make clear that it does not intend to authorize the unlimited discovery suggested in said letter. It does not consider this Order to be any broader than the one submitted by defendant. The Court simply prefers the language employed.

The case is placed on the suspense calendar pending the anticipated arbitration.

So ORDERED.

Dated: New York, New York
May 10, 1976.

/s/ Whitman Knapp
WHITMAN KNAPP, U.S.D.J.

APPENDIX C

Statutes and Rules Involved

UNITED STATES ARBITRATION ACT

Section 2, 9 U.S.C. § 2

Validity, irrevocability, and enforcement of agreements to arbitrate.

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

Section 3, 9 U.S.C. § 3

Stay of proceedings where issue therein referable to arbitration.

If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

SECURITIES EXCHANGE ACT OF 1934

Section 10, 15 U.S.C. § 78j

Regulation of the Use of Manipulative and Deceptive Devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

• • •

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

• • •

Section 28, 15 U.S.C. § 78bb

Effect on Existing Law.

• • •

(b) Nothing in this title shall be construed to modify existing law with regard to the binding effect (1) on any member of or participant in any self-regulatory organization of any action taken by the authorities of such organization to settle disputes between its members or participants, (2) on any municipal securities dealer or municipal securities broker of any action taken pursuant to a procedure established by the Municipal Securities Rulemaking Board to settle disputes between municipal securities dealers and municipal securities brokers, or (3) of any action described in paragraph (1) or (2) on any person who has agreed to be bound thereby.

Prior to June 4, 1975, § 28(b) provided as follows:

(b) Nothing in this title shall be construed to modify existing law (1) with regard to the binding effect on any member of any exchange of any action taken by the authorities of such exchange to settle disputes between its members, or (2) with regard to the binding effect of such action on any person who has agreed to be bound thereby, or (3) with regard to the binding effect on any such member of any disciplinary action taken by the authorities of the exchange as a result of violation of any rule of the exchange, insofar as the action taken is not inconsistent with the provisions of this title or the rules and regulations thereunder.

Section 29, 15 U.S.C. § 78cc

Validity of Contracts.

• • •

(a) Any condition, stipulation, or provision binding any person to waive compliance with any provision of this title or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void.

SECURITIES ACT OF 1933

Section 14, 15 U.S.C. § 77n

Contrary Stipulations Void.

Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this title or of the rules and regulations of the Commission shall be void.

BANKRUPTCY ACT

Section 26, 11 U.S.C. § 49

Arbitration of Controversies.

a. The receiver or trustee may, pursuant to the direction of the court, submit to arbitration any controversy arising in the settlement of the estate.

b. Three arbitrators shall be chosen by mutual consent, or one by the receiver or trustee, one by the other party to the controversy, and the third by the two so chosen or, if they fail to agree in five days after their appointment, the court shall appoint the third arbitrator.

c. The written finding of the arbitrators or of a majority of them as to the issues presented may be filed in court and shall have like force and effect as the verdict of a jury.

Section 60, 11 U.S.C. § 96

Preferred Creditors.

• • •

b. Any such preference may be avoided by the trustee if the creditor receiving it or to be benefited thereby or his agent acting with reference thereto has, at the time when the transfer is made, reasonable cause to believe that the debtor is insolvent. Where the preference is voidable, the trustee may recover the property or, if it has been converted, its value from any person who has received or converted such property, except a bona-fide purchaser from or lienor of the debtor's transferee for a present fair equivalent value: *Provided, however,* That where such purchaser or lienor has given less than such value, he shall nevertheless have a lien upon such property, but only to the extent of the consideration actually given by him. Where a preference by way of lien or security title is voidable, the court may on due notice order such lien or title to be preserved for the benefit of the estate, in which event such lien or title shall pass to the trustee. For the purpose of any recovery or avoidance under this section, where plenary proceedings are necessary, any State court which would have had jurisdiction if bankruptcy had not intervened and any court of bankruptcy shall have concurrent jurisdiction.

Section 67, 11 U.S.C. § 107

Liens and Fraudulent Transfers.

• • •

d.

• • •

(2) Every transfer made and every obligation incurred by a debtor within one year prior to the filing of a petition initiating a proceeding under this Act by or against him is fraudulent (a) as to creditors existing at the time of such transfer or obligation, if made or incurred without fair consideration by a debtor who is or will be thereby rendered insolvent, without regard to his actual intent; or (b) as to then existing creditors and as to other persons who become creditors during the continuance of a business or transaction, if made or incurred without fair consideration by a debtor who is engaged or is about to engage in such business or transaction, for which the property remaining in his hands is an unreasonably small capital, without regard to his actual intent; or (c) as to then existing and future creditors, if made or incurred without fair consideration by a debtor who intends to incur or believes that he will incur debts beyond his ability to pay as they mature; or (d) as to then existing and future creditors, if made or incurred with actual intent as distinguished from intent presumed in law, to hinder, delay, or defraud either existing or future creditors.

Section 70, 11 U.S.C. § 110

Title to Property.

• • •

e. (1) A transfer made or suffered or obligation incurred by a debtor adjudged a bankrupt under this Act which, under any Federal or State law applicable thereto, is fraudulent as against or voidable for any other reason by any creditor of the debtor, having a claim provable

under this Act, shall be null and void as against the trustee of such debtor.

(2) All property of the debtor affected by any such transfer shall be and remain a part of his assets and estate, discharged and released from such transfer and shall pass to, and every such transfer or obligation shall be avoided by, the trustee for the benefit of the estate: *Provided, however,* That the court may on due notice order such transfer or obligation to be preserved for the benefit of the estate and in such event the trustee shall succeed to and may enforce the rights of such transferee or obligee. The trustee shall reclaim and recover such property or collect its value from and avoid such transfer or obligation against whoever may hold or have received it, except a person as to whom the transfer or obligation specified in paragraph (1) of this subdivision e is valid under applicable Federal or State laws.

(3) For the purpose of such recovery or of the avoidance of such transfer or obligation, where plenary proceedings are necessary, any State court which would have had jurisdiction if bankruptcy had not intervened and any court of bankruptcy shall have concurrent jurisdiction.

RULES OF THE SECURITIES AND EXCHANGE COMMISSION

Rule 10b-5, 17 CFR § 240.10b-5

Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to

make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

BANKRUPTCY RULES

Rule 919.

Compromise and Arbitration.

* * *

(b) Arbitration. On stipulation of the parties to any controversy affecting the estate the court may authorize the matter to be submitted to final and binding arbitration.

APPENDIX D

Arbitration Provisions

NEW YORK STOCK EXCHANGE CONSTITUTION, ARTICLE VIII, §1

Any controversy between parties who are members, allied members, member firms or member corporations shall, at the instance of any such party, and any controversy between a nonmember and a member or allied member or member firm or member corporation arising out of the business of such member, allied member, member firm or member corporation, or the dissolution of a member firm or member corporation, shall, at the instance of such nonmember, be submitted for arbitration, in accordance with the provisions of the Constitution and the rules of the Board of Directors.

AMERICAN STOCK EXCHANGE CONSTITUTION, ARTICLE VIII, §1

Members, member firms, partners of member firms, member corporations and officers of member corporations shall arbitrate all controversies arising in connection with their business between or among themselves or between them and their customers as required by any customer's agreement or, in the absence of a written agreement, if the customer chooses to arbitrate.

MASTER AGREEMENT TO THE REALIGNMENT AGREEMENTS, ARTICLE 10.11

Arbitration. duPont and Walston agreed to submit any dispute arising under this Agreement and the Ancillary Agreements or with respect to any of the transactions contemplated thereby to arbitration, in accordance with the provisions of the Constitution of the NYSE and the Rules of the NYSE, except that disputes under the Clearing Agreement relating to transactions executed on an exchange other than on the NYSE, which has in its constitution or rules provisions compelling arbitration among

members thereof, shall be submitted to arbitration in accordance with the Constitution and Rules of such other exchange.

APPENDIX E

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

75 Civ. 3214

WINTHROP J. ALLEGAERT,
as Trustee of duPont Walston Incorporated,
Plaintiff,

—against—

H. ROSS PEROT, ELECTRONIC DATA SYSTEMS CORPORATION, duPONT GLORE FORGAN INCORPORATED, WILLIAM K. GAYDEN, MORTON H. MEYERSON, MILLEDGE A. HART, III, MARGOT PEROT, MERVIN L. STAUFFER, PHM & Co., CHARLESTON INVESTMENT COMPANY, E. D. SYSTEMS CORPORATION, NEW YORK STOCK EXCHANGE, INC., DANIEL J. CULLEN, WILLIAM D. FLEMING, GEORGE T. THOMSON, CHARLES W. COX, DOUGLAS E. DeTATA, JOHN J. DOUGHTY, ALLAN BLAIR and D. TIPP CULLEN,
Defendants.

Complaint

Winthrop J. Allegaert, as Trustee of duPont Walston Incorporated (the "Trustee"), by his attorneys, Hughes Hubbard & Reed, complaining of the defendants, alleges:

JURISDICTION

1. This action arises under Sections 6, 10(b), 20(a) and 29(b) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78f, 78j(b), 78t(a), and 78cc(b) (the "Exchange Act"); SEC Rule 10b-5 promulgated pursuant to Section 10(b) of the Exchange Act ("Rule 10b-5"); Sections 12(2), 15 and 17(a) of the Securities Act of 1933, 15 U.S.C. §§ 77l(2), 77o and 77q(a) (the "Securities Act"); Sections 60(b), 67(d), 70(a) and 70(e) of the Bankruptcy Act, 11 U.S.C. §§ 96(b), 107(d), 110(a) and 110(e); Sec-

tion 352-c of the New York General Business Law, Sections 720 and 1317 of the New York Business Corporation Law, Sections 273 through 276 of the New York Debtor and Creditor Law; Sections 144(a), 251(c) and 271(a) of the Delaware General Corporation Law; and the common law.

2. This court has jurisdiction pursuant to Section 27 of the Exchange Act, 15 U.S.C. § 78aa, Section 22(a) of the Securities Act, 15 U.S.C. § 77v(a), Section 23(b) of the Bankruptcy Act, 11 U.S.C. § 46(b), and principles of pendent jurisdiction.

3. This court has personal jurisdiction over the defendants pursuant to, among other things, Section 27 of the Exchange Act, 15 U.S.C. § 78aa, Section 22(a) of the Securities Act, 15 U.S.C. § 77v(a), and Sections 301 and 302 of the New York Civil Practice Law and Rules ("CPLR"). Personal jurisdiction exists under CPLR Section 302 because the claims alleged herein arise from the facts that each of the defendants or their agents

(a) transacted business within the State of New York, or

(b) committed tortious acts within the State of New York, or

(c) committed tortious acts without the State of New York causing injury to duPont Walston Incorporated, also known as Walston & Co., Inc., within the state and at all relevant times (i) regularly did and solicited business or engaged in other persistent courses of conduct in the state or derived substantial revenue from goods used and consumed and services rendered in the state, or (ii) expected or should reasonably have expected such tortious acts to have consequences in the state and derived substantial revenue from interstate or foreign commerce.

THE PARTIES

4. Plaintiff Winthrop J. Allegaert is Trustee in Bankruptcy of duPont Walston Incorporated, formerly known as Walston & Co., Inc. ("Walston"). Plaintiff was appointed Trustee on May 29, 1974 by order of the Honorable Roy Babitt, Bankruptcy Judge, United States District Court for the Southern District of New York.

5. Walston is, and at all times hereafter mentioned was, a corporation organized and existing under the laws of the State of Delaware with its principal place of business in the City, County and State of New York. For many years prior to July 1973 Walston had carried on a general retail brokerage business and had been one of the largest firms in the brokerage industry.

6. Through a series of fraudulent, unauthorized and otherwise unlawful transactions beginning in or about July 1973, defendants caused many millions of dollars of Walston assets to be transferred to defendant duPont Glore Forgan Incorporated and others and caused many millions of dollars of duPont Glore Forgan Incorporated liabilities to be transferred to Walston.

7. As a result of these transactions, Walston was rendered insolvent. On March 27, 1974, Walston filed a petition for an arrangement under Chapter XI of the Bankruptcy Act, 11 U.S.C. §§ 701 *et seq.* On May 29, 1974, Walston was declared bankrupt.

8. Upon his appointment as Trustee, plaintiff was vested by Section 70a of the Bankruptcy Act, 11 U.S.C. § 110a, with title to all non-exempt property of Walston, including both property transferred by Walston in fraud of its creditors and choses in action.

9. Defendant Electronic Data Systems Corporation ("EDS") is, and at all times material hereto was, a corporation organized and existing under the laws of the

State of Texas. EDS is in the business of designing, installing and operating computerized business information systems for corporate customers.

10. At all times material hereto, defendants H. Ross Perot ("Perot"), William K. Gayden ("Gayden"), Morton H. Meyerson ("Meyerson') and Milledge A. Hart, III ("Hart") were members of the Board of Directors and major stockholders of EDS. Perot has been Chairman of the Board of Directors of EDS since he founded EDS in 1962 and at all times has been the owner of at least 62% of its common stock. At all relevant times, Gayden, Meyerson and Hart operated subject to the direction, dominion and control of EDS and acted as agents and instrumentalities of EDS with respect to the wrongful acts alleged hereinbelow.

11. Defendant duPont Glore Forgan Incorporated ("duPont Glore Forgan") is, and since May 1971 has been, a corporation organized and existing under the laws of the State of Delaware. At all times material hereto, duPont Glore Forgan maintained its principal place of business in the City, County and State of New York. From May 1971 until July 2, 1973 duPont Glore Forgan conducted a general retail brokerage business. duPont Glore Forgan was the successor to the business previously carried on by the partnership of F. I. duPont, Glore Forgan & Co. ("the duPont Glore Forgan partnership").

12. PHM & Co. ("PHM") is, and at all times material hereto was, a partnership formed by Perot, Gayden, Meyerson and Hart to hold the investments of themselves and others in duPont Glore Forgan.

13. Charleston Investment Company ("Charleston") is, and at all times material hereto was, a corporation organized and existing under the laws of the State of Delaware owned entirely by Perot and his wife, Margot Perot ("Mrs. Perot"). Charleston was formed to hold the investments of Perot and Mrs. Perot in Walston.

14. E.D. Systems Corporation ("E.D. Systems") is, and at all times material hereto was, a wholly owned subsidiary of EDS formed to carry out the systems contract EDS had negotiated with Walston. At all relevant times, E.D. Systems operated subject to the direction, dominion and control of EDS and acted as an agent and instrumentality of EDS with respect to the wrongful acts alleged hereinbelow.

15. At all times material hereto, defendants Gayden and Mervin L. Stauffer ("Stauffer") were officers of Charleston. Pursuant to Charleston designations, Gayden became a member of the Walston Board of Directors and a member of its Executive Committee in November 1972 and Stauffer became a member of those bodies in May 1973. Gayden and Stauffer are sometimes hereinafter referred to as the "Nominee Directors".

16. At all times material hereto, defendants Gayden, Meyerson, Hart, EDS, duPont Glore Forgan, E.D. Systems, PHM, Charleston and Stauffer operated subject to the direction, dominion and control of Perot and acted as agents and instrumentalities of Perot with respect to the wrongful acts alleged hereinbelow. Perot, Gayden, Meyerson, Hart, EDS, duPont Glore Forgan, E.D. Systems, PHM, Charleston and Stauffer are sometimes hereinafter referred to as the "Perot Interests".

17. The New York Stock Exchange, Inc. (the "Exchange") is, and at all times material hereto was, a corporation organized and existing under the laws of the State of New York. The Exchange is a national securities exchange registered with the Securities and Exchange Commission pursuant to Section 6 of the Exchange Act. At all times material hereto, Walston and duPont Glore Forgan were member firms of the Exchange.

18. At all times material hereto, defendants Daniel J. Cullen, William D. Fleming ("Fleming"), George T.

Thomson ("Thomson"), Charles W. Cox ("Cox"), John J. Doughty ("Doughty"), Douglas E. DeTata ("DeTata"), Allan Blair, and D. Tipp Cullen were members of the Walston Board of Directors and were active in Walston's business. These directors are sometimes hereinafter referred to as the "Defendant Directors".

19. At all relevant times, certain defendants were controlling persons of certain other defendants within the meaning of Section 15 of the Securities Act and Section 20(a) of the Exchange Act as follows:

(a) Perot was a controlling person of EDS, duPont Glore Forgan, Gayden, Meyerson, Hart, Stauffer, PHM, Charleston, and E.D. Systems.

(b) EDS was a controlling person of duPont Glore Forgan, Gayden, Meyerson, Hart, PHM, Charleston, and E.D. Systems.

(c) Gayden was a controlling person of EDS, duPont Glore Forgan, PHM, Charleston, and E.D. Systems.

(d) Meyerson was a controlling person of EDS, duPont Glore Forgan, PHM, Charleston and E.D. Systems.

(e) Hart was a controlling person of EDS, duPont Glore Forgan, PHM, Charleston, and E.D. Systems.

(f) Mrs. Perot was a controlling person of Charleston.

(g) Stauffer was a controlling person of Charleston.

(h) PHM was a controlling person of duPont Glore Forgan.

Background of Offenses Charged

20. Since its inception, EDS has derived most of its revenues from long term systems contracts with corporate

customers under which it assumes total operating responsibility for the data processing systems of its customers for periods ranging from approximately five to eight years.

21. At the time Perot first invested in the brokerage industry, EDS stock had been trading at extraordinarily high multiples of earnings—more than 100 to 1. The Perot Interests knew that these price-earnings ratios reflected dramatic growth in EDS revenues and earnings; in each year from 1964 through 1969, EDS's net income for the year was more than double that of the year before.

22. The Perot Interests knew that if EDS failed to maintain significant earnings growth, the price of EDS stock—most of which was owned by Perot, Mrs. Perot, Gayden, Meyerson and Hart—would decline substantially.

23. To attempt to maximize its earnings, EDS had developed an "industry center" concept under which it sought to build systems suitable for the needs of an entire industry in conjunction with one or more pilot companies. Once the system was developed, EDS hoped to obtain contracts with other companies in the industry. EDS endeavored to employ this concept in the brokerage industry by obtaining a contract with the duPont Glore Forgan partnership.

Takeover of duPont Glore Forgan by Perot Interests

24. On or about July 3, 1970, EDS entered into a long term systems contract with the duPont Glore Forgan partnership under which EDS was to provide all of the duPont Glore Forgan partnership's electronic data processing requirements for a period of eight years at a minimum average annual charge of $8,000,000. On the same date EDS entered into another agreement with the duPont Glore Forgan partnership to make a loan to the partnership in the form of a subordinated account for an amount in excess of $2 million.

25. Since EDS's after-tax net income was then running at approximately 15% of revenues, the $8,000,000 in annual revenues from the duPont Glore Forgan partnership could be expected to result in annual net income to EDS of approximately $1,200,000. At the price-earnings ratios for EDS stock then prevailing, the $1,200,000 of earnings would represent more than $100,000,000 in market value for EDS stock.

26. Beginning in about the fall of 1970, the duPont Glore Forgan partnership experienced a series of capital crises which threatened the continued existence of the firm. The liquidation of the duPont Glore Forgan partnership would have eliminated the substantial income accruing to EDS under its long term systems contract with the partnership and thereby would have adversely affected the price of EDS stock.

27. To prevent the collapse of the duPont Glore Forgan partnership and the consequent loss to EDS of continued earnings from its contract, Perot, Gayden, Meyerson and Hart invested substantial additional capital in the duPont Glore Forgan partnership and eventually acquired virtually 100% control of the firm. In taking full control of the firm, Perot, Gayden, Meyerson and Hart, acting through PHM, formed duPont Glore Forgan as a corporation to acquire the business of the duPont Glore Forgan partnership.

28. The Exchange contributed to this effort to salvage the duPont Glore Forgan partnership. Under an Indemnification Agreement dated May 14, 1971, the Special Trust Fund of the Exchange (the "Exchange Trust Fund") indemnified PHM against losses of up to $15,000,000 arising out of potential differences between the actual and recorded value of assets and liabilities of the duPont Glore Forgan partnership. The indemnity was effected through the Exchange Trust Fund's issuance to PHM of a non-interest bearing ten year note which was subject to

a five year extension at the option of PHM. The dollar amount ultimately payable pursuant to the Exchange Note was dependent upon the outcome of a series of annual audits of the partnership's assets and liabilities. In April 1972, the Indemnification Agreement was amended to provide that the Exchange Trust Fund's obligation to pay for such losses would be accelerated to the time of any insolvency, liquidation or other marshalling of the assets of duPont Glore Forgan. As part of the indemnity arrangement, duPont Glore Forgan issued a Certificate of Special Interest (the "CSI") to the Exchange Trust Fund which entitled the Exchange Trust Fund to receive cash, securities or other consideration under certain circumstances. The Exchange Trust Fund's right to receive any distribution under the CSI, however, was subordinated to the rights of present and future creditors of duPont Glore Forgan.

29. As a part of the acquisition of the business of the duPont Glore Forgan partnership, duPont Glore Forgan assumed the partnership's contract with EDS. Thereafter, the contract between duPont Glore Forgan and EDS was modified several times. After these modifications, the contract was more profitable to EDS so that in the eleven months prior to July 1, 1973 EDS was earning profits of more than 30 per cent of revenues on the contract—more than double EDS's average rate of profitability on its systems contracts.

30. By July 1, 1973 the Perot Interests had invested more than $70 million in duPont Glore Forgan. Of this sum, $65 million consisted of borrowings by PHM from banks secured primarily by shares of EDS stock owned by Perot.

31. However, the Perot Interests were unsuccessful in operating the business of duPont Glore Forgan. From the time the Perot Interests formed duPont Glore Forgan to July 1, 1973, duPont Glore Forgan suffered huge operat-

ing losses. In the one year period ending May 31, 1973 duPont Glore Forgan lost almost $24 million, of which more than $10 million was lost in the last quarter of the period. And in June 1973, the firm's losses were nearly $4 million.

32. As a result of these operating losses, duPont Glore Forgan's capital position deteriorated substantially. In consequence, the firm, which had been on the Special Surveillance List of the Exchange since July 1972, was placed under restrictions by the Exchange pursuant to Exchange Rules 325 and 326 (the "Net Capital Rules"). The Net Capital Rules provide in substance that a member firm may not expand if its net capital ratio is in excess of 10-1 for more than 15 days, must reduce its business if its net capital ratio is in excess of 12-1 for more than 15 days, and may not operate at all if its net capital ratio is more than 15-1. The Net Capital Rules further provide that the Exchange may impose additional capital restrictions on member firms.

33. On May 23, 1973, in response to reports that duPont Glore Forgan's net capital ratio had been substantially in excess of 11-1 since early May, the Exchange restricted duPont Glore Forgan from expanding its business, ordered it to reduce its net capital ratio to 10-1 by May 29, 1973, and ordered the general partners of PHM to commit in writing to maintain duPont Glore Forgan's net capital ratio at that level—duPont Glore Forgan failed to reduce its net capital ratio as ordered, and by May 31, 1973, its net capital ratio exceeded 14-1.

34. On June 7, 1973, the Board of Directors of the Exchange met and directed duPont Glore Forgan immediately to reduce its net capital ratio to 11-1 and to further reduce the ratio to 10-1 by June 13. If by June 13 duPont Glore Forgan had decided to go forward with a combination with Walston, the reduction was to be accomplished by an infusion of capital; if not, the ratio was to be

reduced by immediately delivering out to other firms duPont Glore Forgan accounts. Although duPont Glore Forgan claimed to have reduced its net capital ratio to 11-1, it did not meet its obligation to attain a 10-1 ratio by June 13.

35. Finally, on June 21, 1973 the Exchange ordered duPont Glore Forgan to maintain its net capital ratio under 11-1 until July 2 and to reduce it to 10-1 by that date. The Exchange warned that if duPont Glore Forgan's net capital ratio were not less than 10-1 by July 2, it would immediately give publicity to the firm's financial condition, a step which would have ended duPont Glore Forgan's ability to remain in business.

36. In the face of these facts, the Perot Interest in May 1973 prepared detailed plans to liquidate duPont Glore Forgan and notified the Exchange that they expected to liquidate duPont Glore Forgan if no agreement with Walston was reached.

Takeover of Walston by Perot Interests

37. The Perot Interests had determined that if duPont Glore Forgan were liquidated, substantially all of their investment would be lost and there would be insufficient funds remaining to repay the principal and interest on the $65 million which had been borrowed from banks to finance the investment.

38. The Perot Interests knew that if duPont Glore Forgan were liquidated, the price of EDS stock would decline because of the loss to EDS of revenues from the duPont Glore Forgan contract and the loss to EDS of the flagship company in its effort to establish an industry center in the brokerage industry.

39. To avoid these consequences and to obtain other benefits for themselves and others which they wished to

favor, the Perot Interests determined to impose upon Walston a fraudulent, improper and unlawful transaction.

40. The Perot Interests were able to accomplish this objective in part because certain of their number—Gayden, Stauffer, E.D. Systems, EDS, Perot, Mrs. Perot, and Charleston—had fiduciary relationships with Walston, access to its inner councils, and knowledge of its confidential business information which they used to benefit the Perot Interests in disregard of their fiduciary duties to Walston.

41. In July 1972, Walston had entered into two agreements under which Perot had agreed to make a capital investment in Walston and Walston had agreed to employ EDS to do its data processing work. The data processing contract, which formally had been entered into by E.D. Systems, a wholly owned subsidiary of EDS, had been substantially less profitable to EDS than its contract with duPont Glore Forgan. The capital investment had been made by Perot and Mrs. Perot through Charleston. The total capital investment required of Charleston was $15 million, $10 million of which had been invested prior to July 1, 1973. In return for the investment, Charleston had received convertible preferred stock, warrants and notes, and the power to name Gayden and Stauffer to Walston's Board of Directors and Executive Committee.

42. Beginning late in 1972 discussions were had from time to time between representatives of Walston and representatives of the Perot Interests regarding the possibility of a merger between Walston and duPont Glore Forgan. Then in late May 1973 at a time when duPont Glore Forgan was in its deep capital crisis and on the verge of liquidation, the Perot Interests proposed a transaction radically different from those previously discussed.

43. Although the proposed transaction contemplated that all the operations of duPont Glore Forgan and Walston would be combined and a single comprehensive brok-

erage business would result, it did not take the usual form. Rather than a merger in which each party would receive stock in the merged company in accordance with its contribution and participate in all business risks of the combined enterprise, the Perot Interests proposed a peculiar form of transaction (the "Perot Plan") in which each of the existing companies would perform exclusively certain of the functions of a brokerage business while the other company performed the remaining functions. In substance, the Perot Plan called for duPont Glore Forgan to carry out all back office operations, including clearing of securities, accounting, and the like, and for Walston to carry out all front office operations, including sales and operation of the branch office system. Thus, the Perot Plan would result in two firms incapable of operating alone and wholly dependent on each other since each would carry out only a part of the necessary activities of a single business. The Perot Interests demanded that Walston agree to the Perot Plan no later than July 1, 1973. The Perot Interests proposed this unusual form of transaction in order to accomplish the improper and unlawful purposes set forth below.

44. The Perot Interests sought to effectuate the Perot Plan in order (a) to obtain Walston assets for grossly inadequate consideration, (b) to transfer duPont Glore Forgan liabilities to Walston without paying Walston for assuming them, (c) to gain control of Walston without paying any consideration in order to use its assets to benefit themselves and others which they wished to favor, (d) to insulate duPont Glore Forgan from all losses from the operations of the combined brokerage business, thereby preserving a substantial part of their investment required to repay PHM's bank loans, and (e) to maintain and extend as long as possible an unreasonably high flow of revenues and profits to EDS.

45. The Perot Plan was to be implemented by a series of agreements (the "Realignment Agreements"). Defend-

ants Thomson and Cox under the general supervision of defendants Daniel J. Cullen and Fleming were responsible for negotiating with the Perot Interests on behalf of Walston with regard to the Realignment Agreements. During such negotiations, defendants Thomson, Cox, Daniel J. Cullen and Fleming failed to protect the interests of Walston and acceded to numerous unfair, improper and unlawful terms proposed by the Perot Interests.

46. In June 1973, the Perot Interests prepared projections showing what Walston's income and expenses would be if the Perot Plan were adopted. On or about June 13, 1973 the Exchange staff prepared a report analyzing these projections. The report concluded that these projections were unduly optimistic; rather than the profit envisioned in the projections, the Exchange staff concluded that Walston would lose in excess of $1,300,000 per month under the Perot Plan and that Walston could remain in business for only eight months under the plan before its excess capital would be completely depleted. On or about June 23, 1973, copies of the Exchange staff report were furnished to duPont Glore Forgan, Meyerson, Thomson and Cox.

47. Prior to July 1, 1973, representatives of the Perot Interests met with the Department of Justice with regard to the application of the antitrust laws to the Perot Plan The representatives of the Perot Interests informed the Department of Justice that duPont Glore Forgan was a failing company and submitted documentation of duPont Glore Forgan's record of losses, its extensive and fruitless efforts to find another merger partner or major investor, and its detailed plans of liquidation if Walston did not agree to the Perot Plan.

48. Despite the enormous consequences of the Perot Plan to Walston and the complexity and unusual nature

of the arrangements developed to effectuate it, most members of Walston's Board of Directors were given very little information as to the Perot Plan until the day before the vote was to be taken on the plan. The sole item of written material concerning the Perot Plan furnished to most directors prior to that date was a four page memorandum containing barely more than a page as to the financial aspects of the plan and omitting most of the unfair terms that were included in the final agreements.

49. The Realignment Agreements were numerous, lengthy and complex. They consisted of a Master Agreement and various ancillary agreements, notably a Clearing And Related Services Agreement ("Clearing Agreement"), a "Transfer Agreement", a "Capital Agreement, an Agreement For Electronic Data Processing Supplies And Services ("EDP Agreement") and an Amendment to the Purchase Agreement ("Charleston Amendment"). Drafts of the lengthy and complex Realignment Agreements were not furnished to most members of the Walston Board of Directors until the day before the July 1, 1973 meeting at which the Perot Plan was to be voted on. Defendants Thomson, Cox, Daniel J. Cullen and Fleming and the Perot Interests knew that the other Walston directors would be unable to digest and comprehend the substance of the agreements in the short span of time available.

50. In fact, the Realignment Agreements were grossly unfair, inequitable, disadvantageous and hazardous to Walston and excessively favorably to the Perot Interests. The following are among the respects in which the agreements were unfair:

a. Pursuant to the Capital Agreement, Walston made a $16,700,000 cash investment in duPont Glore Forgan by purchasing 810 shares of duPont Glore Forgan Series Four Preferred Stock at $10,000 per share and an $8,600,000 subordinated debenture. The amount paid for such securities was greatly in excess of their value in light

of duPont Glore Forgan's financial condition and the extraordinarily unattractive terms of the securities.

b. Pursuant to the Transfer Agreement, Walston purchased most of the assets comprising duPont Glore Forgan's branch office system and other front office departments. Walston paid the book value appearing on an unaudited balance sheet for assets such as lease-hold improvements, office fixtures, furniture and equipment and it assumed all duPont Glore Forgan liabilities with respect to the transferred assets, including lease obligations, even leases on approximately 16 offices which already had been closed. In light of the large operating losses attributable to duPont Glore Forgan's branch offices, the payment of book value constituted a grossly excessive price to pay for these assets; indeed, Walston should have been paid several million dollars for agreeing to assume the lease liabilities.

c. Pursuant to the Clearing Agreement, Walston was obligated to reimburse duPont Glore Forgan for *all* expenses (including all payments to EDS) incurred by duPont Glore Forgan in performing its back office services under the Clearing Agreement. This reimbursement of expenses was excessive since Walston could have had equivalent services performed at a substantially lower cost. As a purported advance or security payment for the rendering of duPont Glore Forgan's services under the Clearing Agreement, Walston was required to pay $3,000,000 to duPont Glore Forgan on or before July 2, 1973. This sum was to be subordinated to the claims of present and future creditors of duPont Glore Forgan and was not to be subject to repayment in the event of Walston's bankruptcy or liquidation. The Clearing Agreement also imposed responsibility on Walston for future losses respecting customer accounts caused by duPont Glore Forgan's negligence. Although duPont Glore Forgan thus bore no risk of loss, it would share any gain through a

provision in the Clearing Agreement granting it a substantial percentage of any Walston profits.

d. Pursuant to the EDP Agreement, duPont Glore Forgan and Walston guaranteed E.D. Systems a net pretax profit for the fiscal year equal to the sum of the profits made by EDS and E.D. Systems in the prior fiscal year under their agreements with duPont Glore Forgan and Walston. Although the guaranty was to be paid by duPont Glore Forgan in the first instance, it would actually be borne by Walston in view of Walston's obligation under the Clearing Agreement to reimburse duPont Glore Forgan for payments to E.D. Systems. This provision was unfair since the cost of the guaranty was unrelated to the value of the services rendered to Walston under the EDP Agreement. Additionally, Walston was unfairly required to pay E.D. Systems $2.5 million at the rate of $100,000 per month on account of its costs in connection with its ceasing to render services under *both* of the prior contracts and in connection with systems conversion and other work required by virtue of the consolidation of the back office operations of the companies. Furthermore, the payments for services required by the EDP contract were unfair and excessive.

e. Pursuant to the Charleston Amendment, Charleston was permitted to gain voting control of Walston by exchanging 398,803 shares of non-voting preferred stock for an equal number of shares of a new series of preferred stock, each share of which had the voting rights of ten shares of common stock. Charleston thereby acquired 55% voting control of Walston. Although the acquisition of such control should have required a payment to Walston of more than $30 million, the Perot Interests acquired control without paying Walston anything at all.

51. The overall effect of the Perot Plan was as follows: Since all of duPont Glore Forgan's expenses were reimbursed by Walston under the Clearing Agreement and

its branch office liabilities assumed by Walston under the Transfer Agreement, the Perot Interests insulated their capital in duPont Glore Forgan from further dissipation by reason of duPont Glore Forgan's huge monthly operating losses. This insulation against risk came at the direct expense of Walston which became fully liable for all expenses and liabilities, and hence losses, of the combined brokerage system. At the same time, duPont Glore Forgan maintained potential for profit through substantial participation in any profit that might be earned by the combined brokerage systems. Through Walston's assumption of the duPont Glore Forgan expenses and the excessively favorably contract between duPont Glore Forgan and EDS, the Perot Interests were also able to sustain a high earnings flow to EDS. In addition to assuming all of these risks and obligations, Walston was required to pay many millions of dollars for the virtually worthless securities of a failing company and assets of a branch office system which had been generating huge losses at an accelerating rate. Finally, the Perot Interests obtained voting control of Walston without having to pay for it.

52. Although the Exchange knew that the Perot Plan was unfair to Walston, the Exchange on June 29, 1973 granted the approvals and exemptions which under its rules were necessary to permit the Perot Plan to be implemented. At the time it granted such approvals and exemptions, the Exchange knew that if duPont Glore Forgan were liquidated, the Exchange Trust Fund would be immediately liable to pay most, if not all, of the $15,000,000 face amount of the Exchange Note. The Exchange Trust Fund, however, did not then contain any of the funds necessary to pay the obligation, for the Exchange had not yet assessed and collected such funds from its members. In addition, since the CSI held by the Exchange Trust Fund was subordinated to the claims of duPont Glore Forgan's creditors, the Exchange knew that the liquidation of duPont Glore Forgan would eliminate

any prospect of the Exchange Trust Fund realizing any return upon the CSI.

53. The Perot Plan and the Realignment Agreements pursuant thereto called for, among other things, a number of purchases and sales of securities, including: (a) the purchase by Walston of duPont Glore Forgan preferred stock for $8,100,000; (b) the purchase by Walston of a duPont Glore Forgan subordinated debenture for $8,600,000; (c) the exchange by Charleston of 398,803 shares of Walston's Series A preferred stock for an equal number of shares of Walston's Series B preferred stock; (d) the transfer of securities in customer and principal accounts from Walston to duPont Glore Forgan; (e) the grant by Walston of options to purchase its stock to duPont Glore Forgan; and (f) the grant by duPont Glore Forgan of options to purchase its stock to Walston.

54. On July 1, 1973, the Walston Board of Directors held a special meeting in New York City to consider and vote upon the Perot Plan. In connection with their efforts to induce members of Walston's Board of Directors to vote in favor of the Perot Plan, and to prevent shareholders and other interested parties from taking steps to block effectuation of the Perot Plan, certain defendants made untrue statements of material fact, omitted to state facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, employed devices, schemes and artifices to defraud and engaged in acts, practices and courses of business which operated as a fraud upon Walston as follows:

a. Thomson, Cox, Daniel J. Cullen, Fleming and the Perot Interests misrepresented Walston's financial position, its ability to retain capital, and the length of time it could remain in business without the Perot Plan:

(i) They falsely represented that adoption of the Perot Plan was necessary to save Walston from

prompt liquidation and that without the Perot Plan Walston would be forced into liquidation within two months. In fact, Walston was in no danger of prompt liquidation, and the true purpose of the Perot Plan was to prevent the immediate liquidation of duPont Glore Forgan. Walston's net capital ratio as of June 30, 1973 was less than 7.9-1, far below duPont Glore Forgan's ratio. Over a three year period, Walston had lost only $1 million, while duPont Glore Forgan had lost $27,000,000, and in the six months prior to July 1, 1973 duPont Glore Forgan's losses were nearly triple those of Walston. Unlike duPont Glore Forgan, Walston was not on the Exchange's Special Surveillance List.

(ii) They falsely represented that if Walston did not approve the Perot Plan, Bank of America would immediately withdraw its $2½ million subordinated capital, that this would result in the withdrawal of the $5 million subordinated capital which had been invested by Security National Bank, and that a chain reaction would develop leading to the prompt exodus of large amounts of subordinated capital and the collapse of Walston within two months. In fact, under the terms of the subordinated loan agreements, Bank of America and all other subordinated lenders could in no event withdraw their capital on less than six months' notice and no such withdrawal would be permissible after six months if the effect of the withdrawal would be to increase Walston's net capital ratio to more than 10-1.

b. The Perot Interests, the Exchange, Thomson and Cox failed to disclose duPont Glore Forgan's true financial condition and misrepresented facts relating thereto:

(i) The Perot Interests, the Exchange, Thomson and Cox failed to disclose that duPont Glore Forgan

had critical capital problems, that duPont Glore Forgan had been placed under restrictions in its business by the Exchange, that duPont Glore Forgan had violated several recent Exchange directives regarding its capital, and that the Exchange had stated its intention of giving publicity to duPont Glore Forgan's financial condition on July 2, 1973 unless its net capital ratio was reduced to 10-1 by that date.

(ii) The Perot Interests failed to disclose that the Perot Interests had represented to the Department of Justice that duPont Glore Forgan was a failing company and failed to disclose the facts submitted to the Department of Justice to support the representation.

(iii) The Perot Interests failed to disclose that the Perot Interests had made plans to liquidate duPont Glore Forgan promptly if the Perot Plan were not approved by Walston.

(iv) Meyerson, acting on behalf of the Perot Interests, misrepresented duPont Glore Forgan's Net Capital Ratio and falsely stated that he did not know whether duPont Glore Forgan was on the Exchange's Special Surveillance List.

c. The Perot Interests and certain others misrepresented that Walston's two principal subordinated lenders—Security National Bank and Bank of America—regarded the Perot Plan as being in Walston's best interests:

(i) The Perot Interests and Thomson, Cox, Daniel J. Cullen and Fleming furnished to the members of Walston's Board of Directors documents indicating that Security National Bank, which had made a subordinated loan to Walston of $5 million, had consented to the Perot Plan, without disclosing that Security National Bank had actually refused to consent to such plan. This non-disclosure was of particular importance in view of the misrepresentations described

above to the effect that Security National Bank would withdraw its subordinated capital if the Perot Plan were not approved.

(ii) The Perot Interests, Thomson, and Bank of America misrepresented to members of Walston's Board of Directors that Bank of America regarded the Perot Plan as in Walston's best interests. Thus, Bank of America threatened to give notice of acceleration of its $2½ million subordinated loan to Walston unless the Perot Plan were approved. In fact, Bank of America knew that the Perot Plan would disastrously weaken Walston and substantially increase the risks on its $2½ million loan to Walston. However, unknown to most Walston directors, Bank of America was also the head of a group of banks which had loaned $50 million to PHM for investment in duPont Glore Forgan. Thus, unknown to most Walston directors, Bank of America's true reason for desiring approval of the Perot Plan, was to obtain the benefits of increased security on the $50 million loan at the cost of reduced security on the $2½ million loan. (Following the adoption of the Perot Plan, the Perot Interests, Thomson, Cox, Daniel J. Cullen and Fleming fraudulently caused Walston to give Bank of America full security for the $2½ million loan, so that Bank of America was relieved of the risk even on that loan.) Although the Perot Interests knew Bank of America's true reasons for seeking approval of the Perot Plan, they failed to disclose them to Walston's Board of Directors.

d. The Perot Interests and other defendants made misrepresentations and non-disclosures concerning the terms of the Perot Plan and the effects on Walston of the adoption of the Perot Plan:

(i) The Perot Interests and Thomson and Cox presented to the Walston Board of Directors documents

prepared by the Perot Interests projecting profitable operations for Walston assuming adoption of the Perot Plan without disclosing that an Exchange staff report had analyzed the projections, had concluded that they were in error, and had developed projections showing that Walston would lose in excess of $1,300,000 per month and thereby would completely exhaust its excess net capital within eight months. In response to a question from a Walston director seeking the Exchange's view as to whether Walston would operate profitably after the Realignment, the Exchange representatives present at the July 1 Board Meeting failed to disclose the existence of the Exchange report projecting large losses and referred instead to the documents prepared by the Perot Interests projecting profits.

(ii) The Perot Interests failed to disclose that in basing the new agreement with EDS on the old duPont Glore Forgan contract, they had given the benefit to EDS of a form of contract which in the eleven months preceding July 1, 1973 had been more than twice as profitable as EDS' average contract and more than three times as profitable as E.D. Systems' contract with Walston.

(iii) The Perot Interests represented to members of Walston's Board of Directors that certain key management functions at Walston and duPont Glore Forgan after the effectuation of the Perot Plan would be performed by persons then employed by Walston rather than by persons then employed by duPont Glore Forgan.

(iv) Because Thomson, Cox, Daniel J. Cullen, Fleming, Gayden and Stauffer did not give drafts of the numerous, lengthy, and extraordinarily complex Realignment Agreements to most of the other mem-

bers of Walston's Board of Directors until the day before the meeting at which the agreements were to be voted on, they effectively concealed from such other members most of the material terms of the agreements.

e. The Perot Interests and Thomson, Cox, Daniel J. Cullen and Fleming failed to disclose that Walston had not adequately evaluated the Perot Plan and had not investigated the financial condition of duPont Glore Forgan.

f. The Perot Interests and those of the Defendant Directors who were involved failed to disclose the offers of benefits which had been made to certain directors in return for their agreement not to negotiate the Realignment Agreements at arms' length, to vote in favor of the Perot Plan, or both.

g. The Perot Interests and the Exchange misrepresented to the Walston Board of Directors that the Exchange had no pecuniary interest in salvaging duPont Glore Forgan. The Perot Interests and the Exchange failed to disclose that the liquidation of duPont Glore Forgan would have compelled the Exchange Trust Fund to make immediate payment of most, if not all, of the $15,000,000 Exchange Note and that the Exchange Trust Fund did not have the funds necessary for such payment.

55. The Perot Interests, Thomson, Cox, Daniel J. Cullen and Fleming sought and obtained shareholder approval to an amendment of Walston's certificate of incorporation changing Walston's name to duPont Walston Incorporated without disclosing the information set forth in paragraph 54 above to Walston's shareholders.

56. The Perot Interests and Thomson, Cox, Daniel J. Cullen and Fleming falsely stated in a June 6, 1973 letter to Walston shareholders and subordinated lenders that the Perot Plan would strengthen Walston's capital posi-

tion, that Walston's expenses would not increase in proportion to the added production from duPont Glore Forgan's offices, and that Walston would be in a much stronger position as a result of the Perot Plan.

57. Several hours after the July 1, 1973 meeting began and prior to the vote on the Perot Plan, Walston director George U. Robson left the board room and retired to his hotel room because of illness. Before leaving the meeting, Robson had expressed his opposition to the Perot Plan. Although it was a regular practice at Walston for directors to participate in Board of Directors meetings by telephone, Daniel J. Cullen, Chairman of the Walston Board of Directors, failed to telephone Robson when the vote was taken to obtain Robson's vote. In failing to take Robson's vote, defendant Daniel J. Cullen was acting on behalf of the Perot Interests and Thomson, Cox and Fleming.

58. In the absence of Robson's vote, ten votes were cast in favor of the Perot Plan and nine votes were cast in opposition. The ten directors voting in favor of the plan were the Defendant Directors and the Nominee Directors. Of the Defendant Directors voting in favor of the plan, at least two—DeTata and Doughty—had expressed the intention to vote against the plan but thereafter agreed with the Perot Interests to vote in favor of it in return for certain benefits.

59. The ten to nine vote did not constitute valid corporate approval or authorization of the Perot Plan because:

a. the Perot Plan was not approved by a majority of disinterested directors and was unfair to Walston. Of the ten directors voting in favor of the plan, at least two—Gayden and Stauffer—were interested directors in that they were officers of, directors of, or had financial interests in, other parties to the Realignment Agreements.

Thus, no more than eight disinterested directors voted in favor of the plan while nine voted against it.

b. certain of the Defendant Directors voting in favor of the Perot Plan, including Thomson, Cox, Daniel J. Cullen, Fleming, DeTata and Doughty, had made unlawful agreements with the Perot Interests to vote in favor of the Perot Plan in return for certain benefits to themselves.

c. the vote of Walston director George U. Robson was not obtained.

d. the approval of Walston's shareholders was not obtained; shareholder approval was required because:

(i) the Perot Plan was a merger between duPont Glore Forgan and Walston within the meaning of Section 251 of the Delaware General Corporation Law;

(ii) the Perot Plan constituted a sale or exchange of substantially all of Walston's property and assets within the meaning of Section 271 of the Delaware General Corporation Law, altered the basic nature and structure of Walston's business and eliminated a substantial part of Walston's business.

60. Although Walston was required under the Realignment Agreements to invest more than $16 million in cash in duPont Glore Forgan and to assume duPont Glore Forgan liabilities amounting to many millions of dollars, the Defendant Directors made no examination of duPont Glore Forgan's books and records and did not ask for audited financial statements of duPont Glore Forgan. The Defendant Directors voted in favor of the Perot Plan without reading or comprehending the Realignment Agreements and without giving adequate consideration to the business and financial consequences to Walston of agreeing to the Perot Plan. The Defendant Directors failed to acquaint themselves sufficiently with Walston's capital position and future prospects to permit them to make an adequate assessment of alternatives to the Perot Plan.

61. Walston and its directors, stockholders and creditors relied upon the misrepresentations and non-disclosures and other improper conduct of the Perot Interests and other defendants described above. By reason of such improper conduct, Walston was caused to effectuate the Perot Plan.

62. Pursuant to the Perot Plan the Perot Interests obtained voting control of Walston, majority representation on Walston's Board of Directors and complete operational control of Walston. Pursuant to the Clearing Agreement, duPont Glore Forgan took control of the books, records and administrative functions of Walston. As a result of this absolute control, the Perot Interests were able to further implement their illegal scheme and device in the following ways, among others:

a. the Perot Interests caused expenses, losses and liabilities, including substantial commodity trading losses in duPont Glore Forgan's Frankfurt, Germany office, to be recorded and paid as Walston expenses, losses and liabilities when, in fact, under the Realignment Agreements they were the responsibility of and should have been paid by duPont Glore Forgan. Plaintiff is unable to specify other improper charges because the relevant records are in the hands of the Perot Interests and plaintiff has been denied adequate access to them.

b. The Perot Interests caused Walston to execute and effectuate various unfair, fraudulent and preferential transactions with the Perot Interests and other parties and engaged in other conduct detrimental to Walston and its creditors. Thus, the Perot Interests caused Walston to transfer more than $2 million to duPont Glore Forgan pursuant to a letter modification of the Clearing Agreement dated February 27, 1974, and caused Walston to transfer more than $5.1 million to Bank of America and to Security National Bank, all in fraud of Walston's creditors. Plaintiff is unable to specify each such improper

transaction or act because the relevant records are in the hands of the Perot Interests and plaintiff has been denied adequate access to them.

c. The Perot Interests appropriated assets of Walston, including the services of Walston employees, to their own use. Plaintiff is unable to specify each such appropriation because the relevant records are in the hands of the Perot Interests and plaintiff has been denied adequate access to them.

63. By reason of the effectuation of the unfair Realignment Agreements and the improper charges and transactions imposed on Walston by the Perot Interests, Walston sustained losses of more than $30 million in the period subsequent to July 2, 1973 and became insolvent.

Count I

Against the Perot Interests, The Exchange And the Defendant Directors

64. Repeats and realleges each and every allegation contained in paragraphs 1 through 18 and 20 through 63 above.

65. The Perot Interests, the Exchange and the Defendant Directors, directly and indirectly, by the use of means and instrumentalities of interstate commerce, the mails, and the facilities of a national stock exchange, knowingly and intentionally employed devices, schemes and artifices to defraud, made untrue statements of material fact, omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, and engaged in acts, practices and courses of business which operated as a fraud on Walston and its creditors in, and in connection with, the offer, sale and purchase of securities.

66. By reason of the foregoing, the Perot Interests, the Exchange and the Defendant Directors violated Section 10(b) of the Exchange Act and Rule 10b-5.

Count II

Against the Perot Interests, The Exchange And the Defendant Directors

67. Repeats and realleges each and every allegation contained in paragraphs 1 through 18, 20 through 63, 65 and 66 above.

68. The Perot Interests, the Exchange and the Defendant Directors (a) were aware that the violations alleged hereinabove were being perpetrated by the other defendants, (b) intentionally aided and abetted and assisted in the commission of such violations, and (c) benefitted from the commission of such violations.

69. By reason of the foregoing, the Perot Interests, the Defendant Directors and the Exchange violated Section 10(b) of the Exchange Act and Rule 10b-5.

Count III

Against the Perot Interests And the Defendant Directors

70. Repeats and realleges each and every allegation contained in paragraphs 1 through 18, 20 through 63, 65 and 66 above.

71. Prior to July 1, 1973 the Perot Interests and the Defendant Directors conspired and entered into an illegal contract and agreement to impose the fraudulent, unauthorized and otherwise illegal Perot Plan on Walston in violation of Section 10(b) of the Exchange Act and Rule 10b-5. The Perot Interests and the Defendant Directors were aware of the conspiracy and the wrongs being perpetuated by the other conspirators on Walston in violation

of Section 10(b) of the Exchange Act and Rule 10b-5 prior to the vote on the Perot Plan.

72. Certain of the overt acts carried out by the Perot Interests and the Defendant Directors in furtherance of the conspiracy are set forth in paragraphs 42, 43 and 45 through 63 above.

73. By reason of the foregoing the Perot Interests and the Defendant Directors violated Section 10(b) of the Exchange Act and Rule 10b-5.

Count IV

Against the Exchange

74. Repeats and realleges each and every allegation contained in paragraphs 1 through 18, and 20 through 63 above.

75. In granting the numerous approvals and exemptions necessary for the implementation of the Perot Plan, the Exchange employed its rules so as to enable the Perot Interests to impose an unjust and inequitable transaction and course of trade on Walston.

76. The Exchange knew prior to the execution of the Realignment Agreements that duPont Glore Forgan had violated Section 10(b) of the Exchange Act and Rule 10b-5 in seeking Walston's approval of the Perot Plan. Under Section 6 of the Exchange Act, the Exchange is required to expel, suspend or discipline any member who engages in such violations. In spite of its knowledge of the violations, the Exchange took no disciplinary action against duPont Glore Forgan, and instead permitted the Perot Plan to be effectuated.

77. By reason of the foregoing the Exchange violated Section 6 of the Exchange Act.

Count V

Against the Perot Interests, The Defendant Directors and Mrs. Perot

78. Repeats and realleges each and every allegation contained in paragraphs 1 through 63, 65, 66, 68, 69 and 71 through 73 above.

79. By reason of the foregoing, the Realignment Agreements are void pursuant to Section 29(b) of the Exchange Act. By reason of the foregoing, all other contracts entered into by Walston on or after July 2, 1973 which are violative of Section 10(b) of the Exchange Act and Rule 10b-5 are void pursuant to Section 29(b) of the Exchange Act to the extent that the Perot Interests, Mrs. Perot or the Defendant Directors purport to have acquired any rights thereunder.

Count VI

Against the Perot Interests

80. Repeats and realleges each and every allegation contained in paragraphs 1 through 18, 20 through 63, and 65 above.

81. By reason of the foregoing, the Perot Interests violated Section 17(a) of the Securities Act.

Count VII

Against the Perot Interests

82. Repeats and realleges each and every allegation contained in paragraphs 1 through 18, 20 through 63 above.

83. The Perot Interests offered or sold securities by the use of means or instruments of transportation or communication in interstate commerce or the mails by means of a prospectus and oral communications which

included untrue statements of material facts and which omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

84. The Perot Interests knew, or in the exercise of reasonable care should have known, of the untruths and omissions.

85. By reason of the foregoing, the Perot Interests violated Section 12(2) of the Securities Act.

Count VIII

Against Perot, EDS, Gayden, Meyerson, Hart, Stauffer, PHM and Mrs. Perot

86. Repeats and realleges each and every allegation contained in paragraphs 1 through 63, 65, 66, 68, 69, 71 through 73, 81 and 83 through 85 above.

87. By reaon of the foregoing, the controlling persons set forth in paragraph 19 are liable jointly and severally with and to the same extent as the persons whom they controlled for all violations set forth in counts I through III, VI and VII pursuant to Section 15 of the Securities Act and Section 20(a) of the Exchange Act.

Count IX

Against the Perot Interests And the Defendant Directors

88. Repeats and realleges each and every allegation contained in paragraphs 1 through 18 and 20 through 63 above.

89. To induce or promote the issuance, distribution, exchange, sale, negotiation or purchase of stock in the State of New York, and to thereby obtain money, profit or property:

a. The Perot Interests and the Defendant Directors engaged in the fraud, deception, concealment and false pretenses described above,

b. the Perot Interests made the false representations as to the future set forth in paragraph 56 and subparagraphs 54d.(i) and 54d.(iii) above, which were beyond reasonable expectation and unwarranted by existing circumstances, and

c. the Perot Interests and Thomson, Cox, Daniel J. Cullen and Fleming made the false representations and statements set forth in paragraph 54 above, when they (i) knew the truth thereof, or (ii) with reasonable effort could have known the truth thereof, or (iii) made no effort to ascertain the truth thereof, or (iv) lacked knowledge concerning the representation or statements made.

90. By reason of the foregoing, the Perot Interests and the Defendant Directors violated Section 352-c of the New York General Business Law.

Count X

Against the Perot Interests, The Exchange And the Defendant Directors

91. Repeats and realleges each and every allegation contained in paragraphs 1 through 18 and 20 through 63 above.

92. The Perot Interests, the Exchange and the Defendant Directors knowingly, recklessly, wilfully and, in the case of the Perot Interests, maliciously engaged in the misrepresentations, nondisclosures, acts, practices and courses of business described above.

93. By reason of the foregoing, the Perot Interests, the Exchange and the Defendant Directors committed common law fraud.

Count XI

Against the Perot Interests And the Defendant Directors

94. Repeats and realleges each and every allegation contained in paragraphs 1 through 18, 42, 43, 45, 57 through 59, 62 and 63 above.

95. The Realignment Agreements were not validly authorized pursuant to applicable state law and hence were and are null and void and without any legal force or effect. Notwithstanding the absence of valid corporate approval of the Realignment Agreements, the Perot Interests and Defendant Directors wrongfully and, in the case of the Perot Interests, maliciously, purported to execute and effectuate such agreements on behalf of Walston.

96. By reason of the foregoing, the Perot Interests and the Defendant Directors must account to Walston for their profits and Walston's losses arising from the wrongful execution and effectuation of these agreements.

Count XII

Against the Nominee Directors And the Defendant Directors

97. Repeats and realleges each and every allegation contained in paragraphs 1 through 18 and 20 through 63 above.

98. The Defendant Directors and the Nominee Directors failed to exercise reasonable and ordinary care and prudence in connection with their consideration of the Realignment Agreements. Their conduct with respect to such agreements was grossly negligent and constituted a bad faith, knowing and reckless disregard of the interests of Walston. The Realignment Agreements were so unfair and inequitable as to Walston as to constitute a gross waste of Walston's assets.

99. Further, the Nominee Directors and certain of the Defendant Directors voted in favor of the Realignment Agreements in knowing breach of their fiduciary obligations to Walston and its creditors because of the benefits to themselves and others which they expected would accrue through approval of such agreements.

Count XIII

Against the Perot Interests Except the Nominee Directors

100. Repeats and realleges each and every allegation contained in paragraphs 1 through 18, 20 through 63, 98 and 99 above.

101. The Perot Interests other than the Nominee Directors knowingly, wilfully and maliciously caused the Nominee Directors and the Defendant Directors to breach their fiduciary duties to Walston and to waste Walston's assets and assisted them in doing so.

Count XIV

Against the Perot Interests And the Defendant Directors

102. Repeats and realleges each and every allegation contained in paragraphs 1 through 18, 20 through 63, 98, 99 and 101 above.

103. By reason of the foregoing, the Perot Interests and the Defendant Directors violated Sections 720 and 1317 of the New York Business Corporation Law.

Count XV

Against duPont Glore Forgan

104. Repeats and realleges each and every allegation contained in paragraphs 1 through 16, 42, 43, 62 and 63 above.

105. Pursuant to the Realignment Agreements and amendments thereto, duPont Glore Forgan was obligated to collect and did collect brokerage commissions and other sums of money on behalf of Walston and was obligated to remit a portion of such sums to Walston. In addition, in order to carry out its obligations to Walston under the Realignment Agreements, duPont Glore Forgan was entrusted with much property belonging to Walston.

106. By virtue of its obligations to Walston, duPont Glore Forgan at all times material hereto stood in a fiduciary relationship to Walston with respect to such money and other property.

107. duPont Glore Forgan has failed to make an accounting with respect to the Walston property held by it.

108. duPont Glore Forgan has failed to return the Walston property held by it.

109. By reason of the foregoing, duPont Glore Forgan is required to account to the plaintiff for all monies and properties received by it under the Realignment Agreements and any amendments thereto and is liable to plaintiff for all sums found to be due Walston from duPont Glore Forgan.

Count XVI

Against the Perot Interests

110. Repeats and realleges each and every allegation contained in paragraphs 1 through 16, 42, 43, 63, 105 and 106 above.

111. By making improper charges to Walston purportedly pursuant to the Realignment Agreements and through other improper and unauthorized acts, duPont Glore Forgan knowingly, wilfully, maliciously and unlawfully assumed and exercised ownership over a portion of the money and other property it held on behalf of Walston.

112. Plaintiff cannot now specify the money and other property unlawfully converted by duPont Glore Forgan because the relevant records are in the hands of the Perot Interests and plaintiff has been denied adequate access to them.

113. The Perot Interests other than duPont Glore Forgan, knowingly, wilfully and maliciously aided, abetted and connived with duPont Glore Forgan in converting Walston's money and other property.

114. By reason of the foregoing, the Perot Interests are liable to plaintiff for the conversion of Walston's money and other property.

Count XVII

Against the Perot Interests

115. Repeats and realleges each and every allegation contained in paragraphs 1 through 18 and 20 through 63 above.

116. The Realignment Agreements provided for a series of interconnected transfers between Walston on the one hand and the Perot Interests on the other. These transfers included transfers of property and assumptions of obligations by Walston. Pursuant to the Realignment Agreements, and the amendments thereto, Walston was thus caused to transfer property to the Perot Interests and incur obligations to the Perot Interests from and after July 2, 1973 until the filing of the Chapter XI petition by Watson on March 27, 1973. Plaintiff is unable to specify each such transfer or obligation because the relevant records are in the hands of the Perot Interests and plaintiff has been denied adequate access to them. Such transfers of property and incurrences of obligations are interrelated with one another and constitute a single transfer by Walston under Sections 67d and 70e of the Bankruptcy Act. This transfer will hereinafter be referred to as the "Fraudulent Transfer."

117. At all times material hereto, duPont Glore Forgan was owned and completely dominated and controlled by the other Perot Interests.

118. The benefits and proceeds of the Fraudulent Transfer (as well as the Preferential Transfers and Post-Bankruptcy Transfers as hereinafter defined) which in form were received by duPont Glore Forgan were in actuality received and enjoyed by the other Perot Interests as well.

119. Further, duPont Glore Forgan engaged in various fraudulent transfers to other of the Perot Interests on or after July 2, 1973.

120. At all times from and after July 2, 1973, there existed creditors of Walston with claims which are provable under the Bankruptcy Act.

121. The Fraudulent Transfer was not made "in good faith" or for fair consideration.

122. The Fraudulent Transfer was a fraudulent transfer within the meaning of Section 67d(2)(a) of the Bankruptcy Act and may be recovered by the Trustee for the benefit of Walston's general creditors pursuant to Section 67d(6) and 70e(2) of the Bankruptcy Act because Walston was rendered insolvent by reason of it.

Count XVIII

Against the Perot Interests

123. Repeats and realleges each and every allegation contained in paragraphs 1 through 18, 20 through 63 and 116 through 121 above.

124. The Fraudulent Transfer was a fraudulent transfer within the meaning of Section 67d(2)(b) of the Bankruptcy Act and may be recovered by the Trustee for the benefit of Walston's general creditors pursuant to Sections 67d(6) and 70e(2) of the Bankruptcy Act because it was

made and incurred at a time when the property remaining in Walston's possession was an unreasonably small capital for the business and transactions in which Walston was engaged or in which it was about to engage.

Count XIX

Against the Perot Interests

125. Repeats and realleges each and every allegation contained in paragraphs 1 through 18, 20 through 63 and 116 through 121 above.

126. The Fraudulent Transfer was a fraudulent transfer within the meaning of Section 67d(2)(c) of the Bankruptcy Act and may be recovered by the Trustee for the benefit of Walston's general creditors pursuant to Sections 67d(6) and 70e(2) of the Bankruptcy Act, because it was made or incurred by Walston at a time when it intended to incur or believed that it would incur debts beyond its ability to pay as they matured.

Count XX

Against the Perot Interests

127. Repeats and realleges each and every allegation contained in paragraphs 1 through 18, 20 through 63 and 116 through 120 above.

128. The Fraudulent Transfer was a fraudulent transfer within the meaning of Section 67d(2)(d) of the Bankruptcy Act and may be recovered by the Trustee for the benefit of Walston's general creditors pursuant to Sections 67d(6) and 70e(2) of the Bankruptcy Act because it was made or incurred by Walston with the actual intent to hinder, delay or defraud its existing and future creditors.

Count XXI

Against the Perot Interests

129. Repeats and realleges each and every allegation contained in paragraphs 1 through 18, 20 through 63, and 116 through 121 above.

130. The Fraudulent Transfer was fraudulent within the meaning of Sections 273 through 276 of the Debtor and Creditor Law of New York State and may be recovered by the Trustee for the benefit of Walston's general creditors pursuant to Sections 70e(1) and 70e(2) of the Bankruptcy Act.

Count XXII

Against the Perot Interests

131. Repeats and realleges each and every allegation contained in paragraphs 1 through 18, 62 and 117 through 120 above.

132. During the four month period preceding March 27, 1974, Walston made numerous transfers of its property to the Perot Interests on account of antecedent debts which enabled the Perot Interests to obtain a greater percentage of their debts than other creditors of Walston of the same class. These transfers will hereinafter be referred to as the "Preferential Transfers" Plaintiff is unable to specify each of the Preferential Transfers because the relevant records are in the hands of the Perot Interests and plaintiff has been denied adequate access to them. One Preferential Transfer which the Perot Interests caused Walston to make is the transfer to duPont Glore Forgan of more than $2,000,000 referred to in paragraph 62(b) above.

133. Each of the Preferential Transfers was made at a time when Walston was insolvent.

134. Each of the Perot Interests or his agent knew or had reason to believe that Walston was insolvent at the time of each of the Preferential Transfers.

135. Each of the Preferential Transfers constituted a preferential payment which may be avoided by the Trustee and the proceeds thereof recovered by the Trustee for the benefit of Walston's general creditors pursuant to Section 60b of the Bankruptcy Act.

Count XXIII

Against the Perot Interests

136. Plaintiff repeats and realleges each and every allegation contained in paragraphs 1 through 18, 62 and 117 through 120 above.

137. Plaintiff, upon his appointment as Trustee on May 29, 1974, became vested pursuant to Section 70a of the Bankruptcy Act with title to all of Walston's non-exempt property as of the filing date, March 27, 1974, including all documents relating to its property.

138. Subsequent to March 27, 1974 Walston engaged in transfers of its property to the Perot Interests for which it did not receive present fair equivalent value and with respect to which the Perot Interests were not acting in good faith. Such transfers will hereinafter be referred to as the "Post-Bankruptcy Transfers." Plaintiff is unable to specify each of the Post-Bankruptcy Transfers because the relevant records are in the hands of the Perot Interests and plaintiff has been denied adequate access to them.

139. Each of the Post-Bankruptcy Transfers may be recovered by the Trustee for the benefit of Walston's general creditors pursuant to Section 70 of the Bankruptcy Act.

Count XXIV

Against the Perot Interests

140. Repeats and realleges each and every allegation contained in paragraphs 1 through 18, 62, 117 through 120 and 137 above.

141. To enable duPont Glore Forgan to fulfill its obligations under the Realignment Agreements, it took custody of, but not title to, much of Walston's property, including many of the documents relating to Walston's property.

142. Pursuant to Section 70b of the Bankruptcy Act, a trustee is required to assume or reject any executory contract of a bankrupt within sixty days after the adjudication of bankruptcy or within thirty days after his qualification, whichever is later.

143. Under section 70(b) of the Bankruptcy Act and Rule 607 of the Bankruptcy Rules, any executory contract of a bankrupt not specifically assumed by the trustee within sixty days after his qualification is deemed rejected unless the time for assumption has been extended by the Court.

144. None of the Realignment Agreements or any amendment thereto has been assumed by the Trustee and no extension of time for assumption has been granted. Thus, on or about July 29, 1974 (hereinafter the "Termination Date") all of the Realignment Agreements were deemed rejected and all of their executory features became of no further force or effect.

145. Subsequent to the Termination Date, duPont Glore Forgan has continued to receive property belonging to Walston and has purported to act on Walston's behalf with respect to property belonging to Walston.

146. Although duPont Glore Forgan has ceased to have any right to retain Walston's property, it has refused to comply with the Trustee's demands for return of the

property and has also ignored his request that duPont Glore Forgan stop purporting to act on behalf of Walston.

Wherefore, plaintiff demands judgment

(a) against the Perot Interests on counts I through III, V through XI, XIII and XIV, against the Exchange on counts I, II, IV, and X, against the Defendant Directors on counts I through III, V, IX through XII, and XIV and against Mrs. Perot on count VIII for all damages, including the damages attributable to the wrongful execution and effectuation of the Realignment Agreements, to Walston resulting from the wrongful acts alleged therein, in an amount to be determined on the trial of this action, which amount is not less than $45,000,000;

(b) against the Perot Interests for punitive damages on counts IX through XI, XIII and XIV in an amount not less than $45,000,000 or such higher amount as would equal the damages to Walston and the profits and other benefits derived by the Perot Interests by reason of the wrongful acts alleged therein;

(c) against the Perot Interests on counts I through III, V through XI, XIII and XIV requiring them to account for, pay over and disgorge any and all profits and benefits, or the value thereof, received or enjoyed by them on account of the wrongful acts alleged therein;

(d) against duPont Glore Forgan on count XV requiring it to account to the plaintiff for all sums and other property received by it pursuant to the Realignment Agreements or any amendment thereto and requiring it to pay over to plaintiff any sums found to be due Walston thereunder;

(e) against the Perot Interests on Count XVI for damages in an amount equal to the value of the property converted as well as punitive damages in an amount equal thereto;

(f) against the Perot Interests on Counts XVII to XXI for the value of the Fraudulent Transfer;

(g) against the Perot Interests on Count XXII requiring them to return the property preferentially transferred or, if such property has been converted, requiring them to pay the value thereof;

(h) against the Perot Interests on Count XXIII for the value of the Post-Bankruptcy Transfers;

(i) against the Perot Interests on Count XXIV,

(i) ordering the Perot Interests to turn over to plaintiff any and all property belonging to Walston which they now possess or hereafter may possess or over which they now have, or hereafter may have, custody or control.

(ii) for damages resulting from the wrongful conduct alleged therein,

(iii) preliminarily and permanently enjoining the Perot Interests from selling, assigning, transferring, disposing of or comingling any and all property belonging to Walston which the Perot Interests now possess or hereafter may possess or over which they now have, or hereafter may have, custody or control.

(iv) preliminarily and permanently enjoining the Perot Interests from directly or indirectly acting, purporting to act or representing that they have the authority to act on behalf of Walston or as Walston's agent or representative with respect to any and all property payable to Walston, in the name of Walston, received by the Perot Interests for the account of Walston, or otherwise directed or addressed to Walston or belonging to Walston;

(j) for interest on the amounts demanded herein;

(k) for the costs and disbursements of this action; and

(l) for such other, further and different relief as to the Court may seem just and proper.

Dated: New York, New York

July , 1975

HUGHES HUBBARD & REED

By .....
A Member of the Firm

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APPENDIX F

Unreported Opinions in Other Pertinent Cases

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In the Matter of
BLAIR & CO., INC., *Debtor.* [CAHN]

In Proceedings for An Arrangement

No. 70 B 755

(Filed May 12, 1972)

Memorandum Opinion

ROY BABITT, *Referee:*

Blair & Co., Inc., the debtor in possession and the New York Stock Exchange liquidator have moved for an order pursuant to Sections 3 and 4 of the United States Arbitration Act, 9 U.S.C. §§ 3 and 4, to compel the respondent, Margaret M. Cahn, a claimant in the pending insolvency proceedings involving Blair, to proceed to arbitration in accordance with the terms of her contract with Blair and in essence to continue the stay of the action now pending by her against Blair in the state court. The controlling facts are not genuinely in dispute despite the allegations contained in the first eight paragraphs of Cahn's answer.

Those facts are as follows:

In early 1959 Cahn contributed a secured note to Blair in order to increase its capital. That note was collateralized by marketable securities. Simultaneously with this transaction, Cahn and Blair entered into a collateral agreement setting forth the respective rights of Cahn and Blair. Among other things, Paragraph XIII(f) provided that any controversy arising out of that agreement or its breach was to be submitted to and settled by arbitration in accordance with the constitution of the New York Stock Exchange which sets up the mechanics for such arbitration.

On September 29, 1970, an involuntary petition in bankruptcy was filed against Blair. One day after the filing of that petition, Cahn began her action against Blair, its officers and directors, in the Supreme Court of the State of New York. That action was grounded in the claim that Blair had breached the collateral agreement. As an incident of the filing of the involuntary petition against Blair, this court stayed all suits, but that stay was subsequently modified so that Cahn could proceed against the other defendants but not against Blair. On April 15, 1971, Blair filed its petition for a Chapter XI arrangement under Section 321 of the Bankruptcy Act, 11 U.S.C. § 721, and as an incident to that petition, this court entered another order staying suits.[1]

Five months later, Cahn sought modification of the stay in order to permit her to proceed with pre-trial discovery against Blair. An order authorizing that relief was entered with direction that a hearing be held on Cahn's claim which she filed in this court and which was given Docket No. 10524 on the claims dockets of this court. That claim had been filed after the filing of the Chapter XI arrangement petition by Blair. The substance of that claim is basically the same as the gravamen of the action pending in New York State Supreme Court but stayed as we have already seen. The hearing in respect of Cahn's claim was adjourned to January 10, 1972 whereupon Blair interposed the instant motion which seeks determination of the merits of the claim before an arbitration tribunal as contemplated by Paragraph XIII(f) of the collateral agreement between her and Blair.

Cahn's answer raises various defenses, all of which are pitched to the proposition that the motion to compel arbi-

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[1] The Blair proceedings in this court were referred to Referee Herbert Loewenthal. It has since been re-referred to me by order of Chief Judge Edelstein.

tration should be denied since Blair has waived the right of arbitration because, among other things, Blair cannot resort to a court of equity (which this court clearly is, *Bank of Marin* v. *England,* 389 U.S. 99, 103 (1966) as its hands are unclean, it is barred by laches and, in any event, is equitably estopped now to insist on arbitration at this stage.

The application by Blair and the liquidator is in all respects granted and all defenses raised by Cahn are overruled.

At the outset, it should be noted that the arbitration provision of the collateral agreement is perfectly clear on its face in respect of arbitration and Cahn wisely refrains from suggesting otherwise. In short, Paragraph XIII(f) is "not a narrow, confined clause, but a broad and wide-open undertaking to arbitrate." *Sumaza* v. *Cooperative Association,* 297 F. Supp. 345, 348 (D.C. Puerto Rico 1969). It is thus unnecessary to seek such construction of an ambiguity which will comport with the established policy in favor of arbitration. See *Lundgren* v. *Freeman,* 307 F.2d 104 (9th Cir. 1962). I note, however, that the policy in favor of arbitration is based on a desire to eliminate expense and delay of protracted court proceedings. *Trafalgar Shipping Co.* v. *International Milling Co.,* 401 F.2d 568 (2d Cir. 1968). In any event, for whatever reason, the federal policy in favor of arbitration is part of the warp and woof of the fabric of our jurisprudence. *Cf., Coenen* v. *R. W. Pressprich & Co., Inc.,* 453 F.2d 1209 (2d Cir. 1972). And any doubt that that policy is clearly applicable in bankruptcy proceedings is dispelled, not only by the plain agreement between the parties itself as here which this court recognizes, but also by this court's awareness that arbitration frequently may be an appropriate method for resolving controversies between trustees or debtors in possession and others. See General Order in Bankruptcy 33.

While it is true that a contract right to arbitration may be waived as may any other contract right, a party is held to have waived only when he actively participates in a law suit or takes other action inconsistent with the arbitration right. But there must be a substantial invocation of the litigation machinery for which arbitration is sought as an alternate. See, *e.g., Cornell & Co., Inc.* v. *Barber & Ross Co.,* 360 F.2d 512 (D.C. Cir. 1966).

Certainly it cannot be said in the facts at bar that there has been such substantial invocation of the litigation machinery as to constitute a waiver, for waiver is not to be lightly inferred. Nor is inconsistent action in some respects a defense and any reliance on minor instances of inconsistencies miss the mark. *Carcich* v. *Rederi A/B Nordie, etc.,* 389 F.2d 692 (2d Cir. 1968). It is the presence or absence of prejudice which is determinative of the issue, and none is demonstrated here. Mere participation in a law suit will not do to constitute a waiver for I recognize once more the overriding federal policy in favor of arbitration. So mere delay in seeking a stay of court litigation without a showing of prejudice, is insufficient. And, it must be noted, Blair has not resisted arbitration for Cahn has never sought it. All Blair did was obtain the sweeping stay which the Bankruptcy Act mandates in a bankruptcy proceeding and in a Chapter XI proceeding. Sections 11 and 314 of the Act, 11 U.S.C. §§ 29 and 714.

Cahn refrains from suggesting that Blair acted tardily in seeking a stay of her suit for it is clear that almost simultaneously with the filing of the involuntary petition and then with the petition for an arrangement, orders were sought restraining, among others, Cahn's suit in the New York Supreme Court. Nor is Blair's tardiness in seeking to compel arbitration a defense. See *Carcich* v. *Rederi A/B Nordie, etc., supra,* at 696 including fn.8. Cahn has fallen far short of making a requisite showing to overcome the vigorous policy in favor of arbitration to which reference has been made. See *Hilti, Inc.* v. *Oldach,* 392 F.2d 368 (1st

Cir. 1968). One thing more must be noted. The action of Blair in effectively blocking the continuation of Cahn's suit was the maximum beneficial relief to which it was entitled and it certainly cannot be said that by seeking the maximum relief in the early stages, it must be held to have waived its right to lesser relief now. This is particularly appropriate to note since Cahn filed a claim in these proceedings thereby in effect bringing the entire controversy before this court. Since the debtor could have objected to that claim at any time up to a period following confirmation of the debtor's arrangement (an event which has not yet occurred), it does not follow that by resorting to arbitration to determine the merits of Cahn's claim, the debtor has been guilty of laches in not seeking it sooner in respect of the suit in New York, the prosecution of which was effectively foreclosed to Cahn in any case by the stay orders.

Settle order on notice.

Dated: New York, New York
May 12, 1972

/s/ Roy Babitt
Referee in Bankruptcy

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In the Mater of

Blair & Co., Inc., *Debtor.* [Danford]

In Proceedings for An Arrangement

No. 70 B 755

(Filed June 1, 1973)

Opinion

Appearances:

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By: George Weisz
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Roy Babitt, *Referee:*

Blair & Co., debtor-in-possession (hereafter "Blair") and Scorese, its Stock Exchange Liquidator, have moved

for an order staying this court's examination into the status and validity of the claim filed against Blair by Danford, the respondent in this dispute and for a further order directing arbitration of his claim pursuant to the United States Arbitration Act, 9 U.S.C. §§ 1 *et seq.*

Before turning to the welter of papers filed in support of the motion and by Danford in opposition to it, it is necessary first to set the stage for this controversy by touching on the proceedings in this court involving Blair. These background facts are important in the focus of this particular controversy, but not necessarily material to its resolution, for the material facts, as will appear, are forthright and simple and in the view of this court, do not present a genuine issue of material fact with the result that there is no need for a trial, *Applegate* v. *Top Associates, Inc.*, 425 F.2d 92 (2d Cir. 1970), and the court may pass to the legal questions.

Until late September 1970 Blair was engaged in the general brokerage business and maintained its principal office in New York City. On September 21, 1970, in order to satisfy the claims of customers as well as to effectuate the transferral and delivery of customers' securities, Blair entered into an agreement with the New York Stock Exchange (hereafter "The Exchange"). Under the terms of that agreement, the Exchange was given the power to appoint a liquidator should the trustees of the special trust fund of the Exchange make a loan to Blair or guarantee any of its outstanding obligations. It should be observed that that special trust fund had been established by the Exchange in 1964 for the purpose of avoiding bankruptcy to member firms "with attendant hardship to their customers and loss of confidence in the securities market." Constitution of the New York Stock Exchange, Article XIX, § 1; In the Matter of Blair & Co., Inc., F.2d —— (2d Cir. # 72-1554, Dec. 11, 1972), cert. granted —— U.S. —— (1973).

On September 25, 1970 the trustees of the Exchange's special fund advanced $1,000 to Blair thereby triggering the appointment of Scorese as liquidator. His specific powers as liquidator are not relevant for purpose of the instant controversy save to note that he was to act on behalf of Blair in the administration of its assets and properties, with particular regard to Blair's 25,000 or so customers.

Four days later an involuntary petition in bankruptcy was filed against Blair under the authority of Section 3a of the Bankruptcy Act, 11 U.S.C. § 21(a), alleging three acts of bankruptcy, as to the first two of which no serious attempt was made to support them. *In the Matter of Blair & Co., Inc.*, F.2d —— *supra*, page 935 slip sheet opinion including fn.2. The third act of bankruptcy asserted was that thought by the creditors to be contemplated by Section 3a(5) of the Act—the appointment of a receiver or trustee to take charge of the debtor's property while the debtor was insolvent or unable to pay its debts as they matured. It is unnecessary for purposes of this controversy to do more than brush lightly against the facts that followed Blair's involuntary submission to this court's jurisdiction save to note that the allegations of the third act of bankruptcy were sustained in fact and in law by the Referee and by the District Court on review. While that review to the District Court of the Referee's order was pending, Blair filed a petition for an arrangement under Chapter XI of the Bankruptcy Act, Sections 301 *et seq.*, 11 U.S.C. §§ 701 *et seq.* The particular section pursuant to which Blair filed its petition is Section 321, 11 U.S.C. § 721, authorizing the filing of an arrangement petition during the pendency of a bankruptcy proceeding, here the one begun when the involuntary petition was filed. Blair was authorized to continue its business and manage its property as debtor-in-possession and the Stock Exchange Liquidator was authorized to continue in the discharge of the duties conferred on him by orders entered in October 1970. A stay of the administration of the bank-

ruptcy was entered by Referee Loewenthal to whom this matter had been referred, and Blair has continued its course in the superseding Chapter XI arrangement proceedings to the extent that it has already filed its plan, has had that plan accepted by customers and creditors, and, in keeping with the statutory scheme, and save for pending objections to some of the claims filed by customers and/or creditors, is proceeding to confirm that arrangement. To keep the chronology complete, the Court of Appeals for this Circuit reversed the District Court judgment which upheld the order of adjudication by the Referee and then denied rehearing en banc. The Supreme Court however has granted a writ of certiorari to the United States Court of Appeals for this Circuit. What is further important to set the stage for what follows is that Danford filed a claim for over $1,800,000 against Blair. That claim was assigned # 10,573 on the claims docket of this court. Danford's claim was based on his conclusion that Blair should return that amount for it is due him as a return of net equity in credit balance in his account at Blair as of March 1971 in that amount plus interest. It is plain that the thrust of Danford's claim is that he is entitled to nonsubordinated customer status under the arrangement filed by Blair, for under it customers were offered and have agreed to accept 50% of their claims. Blair and the liquidator, on the other hand, take the position that Danford's claim was subordinated to the claims of Blair's unsubordinated creditors with the result that, if Blair and liquidator are correct, Danford is not entitled to customer status and can accept no yield under Blair's arrangement. So much for the chronology of Blair's history in this court and the assertion of Danford's claim against it.

But more is necessary by way of background facts, these being those facts surrounding Danford's relationship to Blair in the first place. And so I turn to them. Through 1967 and for some forty years before, Danford had been

employed as a registered representative or salesman at the brokerage firm of Schwabacher & Co. During those years Danford maintained an account with Schwabacher which, as of the end of 1967, had grown to an amount in excess of $1,500,000.

In December, 1967 Danford was asked to become a general partner of Schwabacher & Co. with an interest of ½ of 1% in return for an investment of $15,000. Danford accepted the offer by executing the necessary documents and became a general partner of the company. In December, 1967 Danford sought allied membership in the Exchange, an application which appears to have been favorably acted upon.

Danford's expectations of what his partnership in Schwabacher would mean were dashed in July 1968 when the Securities & Exchange Commission directed Schwabacher to restrict transfers from the customer accounts of its partners. Later that year Schwabacher was directed to sell most of its branch offices and/or to merge with another brokerage house. In February, 1969 Danford, and others similarly postured at Schwabacher executed the necessary documents by which it and Blair & Co. were merged. One of these documents was a collateral agreement setting out Danford's rights in his account with Schwabacher insofar as the merger with Blair was to have any impact on it.

Danford then began an action against Schwabacher, some of its partners and Blair in the United States District Court for the Northern District of California. He alleged fraud and misrepresentation in connection with the circumstances by which he, Danford, became involved as a partner of Schwabacher and also by which Schwabacher and Blair merged.

A third series of facts is touched upon only because of a tangential relevance to this controversy between Blair and Danford. It appears that a class action had been

brought by unsubordinated customers in the United States District Court for the Southern District of New York, entitled *Herz, et al.* v. *Vanderbilt, et al.*, 70 Civ 5005, and assigned to District Judge Wyatt. That suit was brought against various officers and directors of Blair and against the New York Stock Exchange. From what has been shown this court, Judge Wyatt set up no special machinery to ascertain the class, but he appears to have left Danford free to vindicate his standing against Blair before this, the Bankruptcy Court. The relevance of this class action is, according to Danford, that Judge Wyatt directed vindication of Danford's claim before the Referee regardless of whether or not arbitration was otherwise indicated.

In any event, standing on the threshold of confirmation of its arrangement, and recognizing the prima facie effect of Danford's huge claim, Section 57a of the Bankruptcy Act, 11 U.S.C. § 93a, and resting on paragraph XIII(f) of Danford's collateral agreement with Blair, executed in February, 1969, calling for arbitration as well as Article VIII, Section 1 of the New York Stock Exchange Constitution, also calling for arbitration between allied members of the Exchange, Blair moved by order to show cause for an order pursuant to Section 3 and 4 of the United States Arbitration Act, 9 U.S.C. §§ 3 and 4, compelling Danford to submit the dispute with Blair upon which his $1,800,000 claim against it is bottomed to arbitration in accordance with the Rules and the Constitution of the New York Stock Exchange. By that motion, Blair further asked this court to stay proceedings before it in respect to the vitality of Danford's pending claim.

It is observed that it was in February, 1969 that Danford applied to the New York Stock Exchange for allied membership, an application which was later granted. Danford's application for such membership in the Exchange among other things, stated that the applicant bound himself to abide by the Constitution and Rules of the Exchange and by all rules and regulations adopted under its

Constitution, including Article VIII, Section 1 to the effect that any controversy between members or allied-members shall at the instance of either party be submitted for arbitration in accordance with the Constitution and the Rules of the Board of Governors. With Blair's motion to compel arbitration the battle of the affidavits began in earnest, for, apart from filing of an answer raising defenses, together with defenses, affidavits, rebuttal affidavits, reply affidavits and supplemental affidavits were filed by both sides. Notwithstanding the charge and counter-charge set forth in the welter of papers, the court is satisfied, as shall appear, that there are no issues of facts and that as a matter of law, Blair's motion to compel arbitration must be granted and Danford's defenses to frustrate that result must be overruled.

The defenses raised by Danford are that Judge Wyatt in the '*Herz* v. *Vanderbilt*' class action directed that Danford's status as a creditor be determined by the Referee, that Blair waived its right to seek arbitration, that Blair is estopped from seeking arbitration, that the provisions of the Constitution of the Exchange are inapplicable because neither Blair nor Danford is presently a member of the Exchange, that Danford could not receive a fair hearing before an arbitration panel composed of members of the Exchange and finally, and probably most importantly that Danford's application for allied membership in the Exchange and his Collateral Agreement which separately and together lie at the basis of Blair's resort to the arbitration machinery were obtained by fraud. Finally, Danford says that inasmuch as he alleges violation of the Securities and Exchange Acts of 1933 and 1934, the agreement relied on by Blair to compel arbitration is barred by the non-waiver provisions of Section 14 of the 1933 Act, 15 U.S.C. § 77n, and by Section 29 of the 1934 Act, 15 U.S.C. § 78cc.

At the outset, I find that the arbitration provision carried at paragraph XIII(f) of the February, 1969 collater-

al agreement is perfectly clear on its face in respect of the arbitration machinery to be resorted to, and Danford refrains, and wisely so, from suggesting otherwise. In short, paragraph XIII(f) is "not a narrow, confined clause, but a broad and wide-open undertaking to arbitrate." *Sumaza* v. *Cooperative Association,* 297 F. Supp. 345, 348 (D.C. Puerto Rico, 1969). It is thus unnecessary for me to undertake construction of an ambiguity in order to find support for the established policy in favor of arbitration, *Lungren* v. *Freeman,* 307 F.2d 104 (9th Cir. 1962). I note, moreover, that the policy in favor of arbitration is based on a desire to eliminate expense and delay of protracted court proceedings in keeping with what the parties agreed upon. See *Trafalgar Shipping Co.* v. *International Milling Co.,* 401 F.2d 568 (2d Cir. 1968). In any event, for whatever reason, the federal policy in favor of arbitration is part of the warp and woof of the fabric of our jurisprudence, *cf., Coenen* v. *R. W. Pressprich & Co., Inc.,* 453 F.2d 1209 (2d Cir. 1972), any doubt that that policy is clearly applicable in bankruptcy proceedings is dispelled, not only by the plain agreement between the parties itself as here and which this court recognizes, but also by this court's awareness that arbitration was considered, even by those who drafted the Bankruptcy Act to be an appropriate method for resolving controversies between trustees or debtors in possession and others. See Section 26 of the Act, 11 U.S.C. § 49, and General Order in Bankruptcy 33.

Nor can Danford seriously contend that the dispute here does not involve commerce within the meaning of the National Arbitration Act. See *Metro Industrial Painting Corp.* v. *Terminal Construction Co.,* 287 F.2d 382 (2d Cir. 1961), to the effect that arbitration clauses should be read expansively to include disputes reasonably contemplated. *cf., Coenen* v. *R. W. Pressprich & Co., Inc., supra.* I am also satisfied that the underlying dispute between Danford and Blair is covered by the Arbitration Act and by the parties' purpose in their agreement. Accordingly, federal

law governs to the extent that it creates a national substantive law encompassing all questions of interpretation and construction of arbitration agreements, *Varley & Tarrytown Associates, Inc.,* F.2d (2d Cir. April 23, 1973, Docket # 72-2221), see also *Coenen* v. *R. W. Pressprich & Co., Inc., supra, Robert Lawrence Co.* v. *Devonshire Fabrics, Inc.,* 271 F.2d 402 (2d Cir. 1959), cert. dismissed 364 U.S. 801 (1960).

It is also clear that the agreement involved in this dispute between Danford and Blair is one "evidencing a transaction involving commerce" within the meaning of Sections 1 and 2 of the Arbitration Act, 9 U.S.C. §§ 1 and 2. It is plain that the sale of securities, Danford's area of endeavor, constitutes a transaction relating to commerce within the meaning of the National Arbitration Act, *Coenen* v. *R. W. Pressprich & Co., supra.* Similarly, a partnership agreement contemplating substantial interstate activity and business involving interstate commerce falls within the meaning of "commerce" carried in the Arbitration Act, *Garfield & Co.* v. *Weist,* 308 F. Supp. 1107 (S.D.N.Y. 1970), affirmed 434 F.2d 849 (2d Cir. 1970), cert. denied 401 U.S. 940 (1971).

Moreover, to come within the meaning of the Arbitration Act it is only necessary to show that the parties contemplated interstate activity, *Metro Industrial Painting Corp.* v. *Terminal Construction Company, supra* at 387 (Lumbard, C.J., concurring). It is therefore, clear and the court so finds, that the contract which was essential to completion of the merger between the two brokerage firms involved interstate commerce and purported to define Danford's right to deal with the securities in his own account, clearly interstate activity within the purview of the federal Arbitration Act.

I turn to those of Danford's defenses rooted in his claim that he was the victim of fraud perpetrated upon him and

which fraud tainted his entire relationship with Schwabacher and Blair and with the Exchange.

In asserting fraud in the inducement of an agreement which turned out badly but which was entered into in the spirit of self-seeking optimism, it is clear that Danford challenges the entire sequence of events and not just the narrow agreement to arbitrate divorced as it were from everything else that took place between the litigants. *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967), means nothing if its essential significance is not a rejection of Danford's claim that he is entitled to have the issue of fraud litigated outside the arbitration mechanism agreed to by him and provided by The Stock Exchange for those allied with it.

In short, the Supreme Court there held that an arbitrator must resolve a claim of fraud in the inducement of a contract controlled by the reach of the federal Arbitration Act in the absence of evidence that the parties intended to withhold that issue from arbitration. And, there is utterly no showing here that when Danford agreed to arbitrate, the parties contemplated that the issue of fraud would be withdrawn from the arbitrators. As the Supreme Court observed in *Prima Paint, supra* at 400, Section 3 of the Arbitration Act requires a Federal Court in which suit has been brought on any issue referable to arbitration under a written agreement to arbitrate to stay such action pending arbitration once the court its satisfied that the issue is indeed arbitrable.

There is no doubt that the issue of fraud in the inducement of the entire agreement which underlies the relationship between Danford and Blair is arbitrable. Danford makes no real showing to support the bald claim that his defense that the arbitration clause itself, severable from all the other portions of the collateral agreement, was induced by fraud; his efforts to raise the question are designed more to overcome the clear holding of *Prima Paint*

than they are to present a real issue to this court rather than to the arbitrators.

The short of it is that the statute does not "permit the Federal Court to consider claims of fraud in the inducement of the contract generally," 388 U.S. at 404. In arguing that the arbitration clause itself was part of an overall fraud which induced every other part of the collateral agreement, Danford merely repeats Justice Black's dissent, 388 U.S. at 408.

Danford does not deny executing the collateral agreement containing the arbitration clause in issue, nor does he allege a single act of fraud specifically and exclusively directed to the arbitration clause within the meaning of the *Prima Paint* ruling. Indeed, in arguing that the arbitration clause in the collateral agreement was fraudulently induced Danford merely alleges that that clause was part of an overall fraudulent scheme tainting everything else in the relationship. This by itself is insufficient to prevent arbitration between the parties in keeping with their agreement. It is, therefore, unnecessary to decide whether Danford's acceptance of benefits under the collateral agreement constitutes such ratification of his contract as to defeat even a clearly shown defense of fraud.

Blair insists, moreover, that Danford is obliged to arbitrate this dispute by virtue of his allied membership in the Exchange because of Article VIII, § 1 of the Constitution of the Exchange which provides for arbitration of "any controversy between parties who are members, and allied members." To meet this assertion, Danford contends that his applications for Exchange membership were all part of the fraudulent scheme against him and, therefore, he cannot be considered as falling within the provisions of the Constitution to which I have just made reference.

Since the Constitution of the Exchange is a contract between each member and the Exchange itself, *Coenen* v. *R. W. Pressprich & Co., supra; Brown* v. *Gilligan, Will*

& Co., 287 F. Supp. 766 (S.D.N.Y. 1968), there is no reason to suppose that the holding in *Prima Paint* has lost any of its vitality. Danford's attack on his own membership status for fraud will not frustrate arbitration where such claim of fraud is not directed specifically to the agreement to arbitrate. Danford does not deny allied membership in the Exchange and, save for his charge that his applications for such membership were part of an overall fraudulent scheme, he makes no effort to show that the fraud alleged was specifically and narrowly directed at his agreement to arbitrate.

The status of membership itself is sufficient to bind the members to the Constitution of the Exchange including its provision for arbitration. *Brown* v. *Gilligan, Will & Co., supra* at 769.

Danford presses his defense by alleging that he never knowingly agreed to arbitrate under the Constitution of the Exchange since his application merely incorporated the provisions of the Stock Exchange Constitution by reference and did not contain a separate arbitration clause. The signing of a pledge to abide by the Constitution is an agreement to arbitrate, and *Coenen* v. *R. W. Pressprich & Co., supra,* forecloses Danford's contrary view as a litigable issue.

Danford next seizes upon *Wilco* v. *Swan,* 346 U.S. 427 (1953), to the effect that Section 14 of the 1933 Securities Act and Section 29 of the 1934 Act preclude the enforceability of the instant agreement to arbitrate. *Wilco* v. *Swan* held that an agreement to arbitrate was unenforceable against a customer of a member firm against whom the "unwilling" customer alleged violations of the 1933 Act.

The Supreme Court read Section 14 of the 1933 Act to forbid waiver of a right to select a forum for redress of grievances and, of course, allegations of violations of provisions of the Securities & Exchange Act were taken as true for purposes of determining whether arbitration is

to be denied because of the non-waiver provisions of those Acts. *Maheu* v. *Reynolds & Company,* 282 F. Supp. 423 (S.D.N.Y. 1967).

But, in making such assertion, Danford is not writing on a clean slate for *Brown* v. *Gilligan, Will & Company, supra,* held the non-waiver provisions of the Securities & Exchange Acts of 1933 and 1934 and the holding of *Wilco* v. *Swan, supra,* inapplicable where the dispute was between parties both of whom are members of the Exchange and not the obviously unequal situation between a customer and member which was present in *Wilco. Coenen* v. *R. W. Pressprich & Company, supra, Axelrod & Co.* v. *Kordich, Victor & Newfield,* 451 F.2d 838 (2d Cir. 1971); *Rust* v. *Drexel Firestone, Inc.,* F. Supp. (S.D.N.Y. 1972).

The question here is whether Danford is a customer within the protection conferred by the Supreme Court in *Wilco* v. *Swan,* or whether he is a member, subject to the agreement he made to arbitrate, under *Brown* v. *Gilligan, Will & Company, supra,* and its progeny. Danford refrains from suggesting that he was not a member of the Exchange but seeks to distinguish *Brown, Coenen,* and *Axelrod,* all *supra,* by asserting that in those cases the party resisting arbitration did not litigate his status as a member which, Danford claims, he now does on his allegation that his membership status was procured by fraud.

But, the bald assertion of fraud practiced on this experienced individual who should, after nearly half a century in the securities business, be considered as a somewhat sophisticated elder statesman, is palpable. His business acumen is disclosed by the financial success he has had in his chosen field of endeavor and his efforts to proclaim such wide-eyed innocence that his will was overborne fail. *Villani* v. *New York Stock Exchange,* 348 F. Supp. 111 (S.D.N.Y. 1972).

Danford next argues that the arbitration provisions of the Exchange's Constitution are not applicable since neith-

er he nor Blair is now a member of the Exchange. *Isaacson* v. *Hayden, Stone, Inc.*, 319 F. Supp. 929 (S.D.N.Y. 1970) forecloses reliance on that claim on its holding that the arbitration provision is applicable to former members since the controversy flows from and is predicated on the business relationship between the parties which arose during membership, 319 F. Supp. at 930. See also *Coenen* v. *R. W. Pressprich & Co., supra; Ayres* v. *Merrill, Lynch et al.*, F. Supp. (D.C.E.D. Pa. 1973).

The remainder of Danford's defenses may be disposed of quite readily. The defense that Blair has delayed in seeking arbitration is insufficient to constitute a waiver. *Carcich* v. *Rederi A/B Nordie*, 389 F.2d 692 (2d Cir. 1968). There has been no such substantial invocation by Blair of this court's litigation machinery as to constitute a waiver, for waiver is not to be lightly inferred. Nor is inconsistent action in some minor respects a defense, and any reliance by Danford on such minor instances of inconsistency misses the mark. It is the presence or absence of prejudice which determines that issue and none is demonstrated here.

Indeed, Danford's claim that he is on the verge of octogenarian status does not avail him for if we proceed on the premise that the policy in favor of arbitration is based on a desire, *inter alia*, to avoid the delay of protracted court proceedings, *Trafalgar Shipping Co.* v. *International Milling Co.*, 401 F.2d 508 (2d Cir. 1968), then it follows that speed and expedition is more likely on resort to the arbitration process. And, it must be noted, Blair has not resisted arbitration for Danford has never sought it. All Blair did was procure the sweeping stay which the Bankruptcy Act mandates in a bankruptcy proceeding and in a Chapter XI proceeding, Sections 11 and 314 of the Act, 11 U.S.C. §§ 29 and 714, so that things could remain in status quo while the bankruptcy processes determine the priorities of Blair in relation to its customers and creditors. And, Danford refrains, and again wisely, from suggesting that Blair acted tardily in staying his suit in California. See *Murray Oil Products Co.* v. *Mitsui & Co.*, 146 F.2d 381, 384 (2d Cir. 1944).

Danford falls far short of making the requisite showing to overcome the vigorous policy in favor of arbitration to which reference has been made. *Hilty, Inc.* v. *Oldach*, 392 F.2d 368 (1st Cir. 1968); *In the Matter of Blair & Company, Inc.* (Babitt, Referee 2/12/72), affirmed September 6, 1972, Brieant, *D.J.*

Reference has already been made to the *Herz* v. *Vanderbilt* dispute settled by District Judge Wyatt. Danford seizes on a statement by Judge Wyatt and by counsel to Blair in support of his assertion that Judge Wyatt directed litigation in this court and that Blair acquiesced. Once more, Danford falls short of the mark, for Judge Wyatt did no more than conclude that this court should assume jurisdiction in the event Blair filed a Chapter XI petition which it would anyway.

Certainly, Judge Wyatt could not amplify this court's jurisdiction beyond what Congress gave it nor could he pass on the merits of a controversy between Blair and Danford which had not yet arisen. All that Judge Wyatt did, and his statement, fairly read, supports this construction, is to note that in the event certain procedures were followed, this court would have jurisdiction over the disputants. But, such jurisdiction includes sending such controversy to an appropriate arbitration forum in keeping with the broad policy in favor of arbitration particularly where not incompatible with the Bankruptcy Act itself. And the statement by Blair's counsel would indicate nothing less. Moreover, it must be observed, Blair was not a party to that litigation. In short, all that Judge Wyatt did was leave the parties free to thrash out their claims in Blair's Chapter XI proceeding and nothing in the record before Judge Wyatt supports Danford's claim that Blair's present counsel waived defenses which could be made to a Referee with jurisdiction over a debtor.

Insofar as Danford contends that he should not be compelled to arbitrate because of the possibility of bias on the part of the Stock Exchange arbitrators who, he says, have a financial interest in the dispute, such claim is premature. Bias may be raised in connection with the award, not now to preclude it. *Petition of Dover Steamship Co.*, 143 F. Supp. 738 (S.D.N.Y. 1956). Nor does *Commonwealth Coating Corp.* v. *Continental Casualty Co.*, 393 U.S. 145 (1968) require a contrary result for that case involved review of a lower court's judgment not to vacate an award already made.

There is ample basis for this court to stay resolution of the dispute between Danford and Blair articulated in Danford's claim filed here and to leave its resolution to what is hoped prompt disposition by the arbitrators.

Insofar as Danford's claim of nearly two million dollars remains pending, it potentially inhibits confirmation of Blair's arrangement. It follows that Blair's arrangement may be threatened unless prompt action is taken. Technically speaking it may be that Blair has not shown itself to be a party aggrieved by the failure, neglect or refusal of Danford to arbitrate with a narrow reading of the language of 9 U.S.C. § 4. *Cf., Fremont, Cake & Meal Co.* v. *Wilson & Co.*, 86 F. Supp. 968 (D.C. Neb. 1949), affirmed 183 F.2d 57 (8th Cir. 1950). However I find no surer indices of Danford's refusal to arbitrate than his efforts to press his suit in California to the extent of ignoring a stay of this court, noted in a previous opinion filed on an application to punish him for contempt, and by the efforts he has put forth in this dispute to resist arbitration.

An order is to be settled on notice staying other proceedings and compelling Danford to proceed to arbitration on his dispute with Blair.

Dated: New York, New York
June 1, 1973

/s/ Roy Babitt
Referee in Bankruptcy

Supreme Court, U. S.
FILED
MAY 26 1977
MICHAEL RODAK, JR., CLERK

In the

Supreme Court of the United States

October Term 1976

No. 76-1478

H. ROSS PEROT, ELECTRONIC DATA SYSTEMS CORPORATION, DUPONT GLORE FORGAN INCORPORATED, WILLIAM K. GAYDEN, MORTON H. MEYERSON, MILLEDGE A. HART, III, MARGOT PEROT, MERVIN L. STAUFFER, PHM & CO., CHARLESTON INVESTMENT COMPANY, E. D. SYSTEMS CORPORATION, DANIEL J. CULLEN, WILLIAM D. FLEMING, GEORGE T. THOMSON AND CHARLES W. COX,

Petitioners,

—against—

WINTHROP J. ALLEGAERT, AS TRUSTEE OF DUPONT WALSTON INCORPORATED,

Respondent,

—and—

NEW YORK STOCK EXCHANGE, INC., DOUGLAS E. DETATA, JOHN J. DOUGHTY, ALLAN BLAIR, AND D. TIPP CULLEN,

Additional Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF OF RESPONDENT WINTHROP J. ALLEGAERT, AS TRUSTEE OF duPONT WALSTON INCORPORATED, IN OPPOSITION

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In the

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Petitioners,

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Additional Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

---

BRIEF OF RESPONDENT WINTHROP J. ALLEGAERT, AS TRUSTEE OF duPONT WALSTON INCORPORATED, IN OPPOSITION

This brief is submitted on behalf of respondent Winthrop J. Allegaert, as Trustee of duPont Walston Incorporated (the "Trustee"), in opposition to the petition of H. Ross Perot and others (the "Perot Group") for a writ of certiorari to the United States Court of Appeals for the Second Circuit.

QUESTIONS PRESENTED

1. Whether a trustee in bankruptcy suing on behalf of creditors pursuant to Sections 60, 67 and 70 of the Bankruptcy Act may be required to arbitrate on the basis of arbitration agreements entered into by the bankrupt?

2. Whether claims asserted by the trustee of a bankrupt stock brokerage firm under the Securities Act of 1933 and the Securities Exchange Act of 1934 may be determined by an arbitrator rather than by a federal court?

STATEMENT OF THE CASE

The petition herein seeks to create issues of national importance where none exists and to conjure up conflicts that are equally illusory. Notwithstanding the notoriety attending the events which gave rise to this action and the importance of the case on the merits, the court below determined only a simple procedural issue: whether a trustee in bankruptcy can be barred from pressing statutory claims under the securities laws and the Bankruptcy Act in federal court on the basis of arbitration agreements he never signed.

This case concerns H. Ross Perot's efforts to extricate himself, at the expense of duPont Walston Incorporated ("Walston") and its creditors, from a disastrous involvement with the brokerage business. Winthrop J. Allegaert, Walston's bankruptcy trustee, has charged Perot and 19 other defendants with responsibility for a complex scheme under which they siphoned off the assets of Walston to duPont Glore Forgan, Incorporated ("DGF Inc."), and caused the liabilities of DGF Inc. to be shifted to Walston, thereby resulting in the bankruptcy of Walston, "one of the most celebrated brokerage house failures in the history of Wall Street" (10a; footnote omitted).

Defendants in the suit include Perot, Electronic Data Systems Corporation ("EDS"), DGF Inc., the New York Stock Exchange, Inc. ("NYSE"), several Perot associates and investment vehicles, and the Walston directors who voted in favor of Perot's scheme. The twenty-four counts of the complaint allege violations of the Securities Act of 1933, the Securities Exchange Act of 1934, the Bankruptcy Act, and various provisions of New York and Delaware law. The prayer for relief seeks actual damages of $45 million from all defendants and punitive damages in a like amount from certain defendants.

The Trustee's detailed complaint (47a-91a), was concisely summarized in the opinion below:

"Perot is the founder and controlling stockholder of EDS, which operates data processing systems for corporate customers. In the early 1970's, Perot invested about $70 million in, and took control of, the brokerage firm later known as DGF Inc. Perot had borrowed most of the money and had pledged EDS stock as collateral, but the value of that stock depended on continued income from EDS's contract with DGF Inc. By spring 1973, however, DGF Inc. was in bad shape; insufficient capital had brought it to the verge of liquidation. That event would have threatened Perot's entire financial empire and to avoid it, Perot came up with the scheme (the Perot Plan) that involved Walston, in which Perot was a minority investor.

"The trustee describes the Perot Plan as a series of unusual transactions by which Walston would assume all front office operations of the two firms and DGF Inc. would assume back office operations. All of the liabilities of DGF Inc.'s failing branch office system would be shifted to Walston, including lease liabilities on many offices, some

already closed. Walston would pay DGF Inc.'s expenses and make a $2 million advance on them. In addition, Perot would exchange his non-voting preferred stock in Walston for a new series of preferred stock with more voting rights than all of Walston's common stock. Thus, the Plan would protect DGF Inc.'s capital against future loss, while Walston would assume immense liabilities.

"According to the trustee, the Perot Plan was railroaded through the Walston Board of Directors in July 1973 by a vote of 10-9, after insufficient notice of the lengthy and complex realignment agreements and at a Sunday Board meeting that lasted until the early hours of Monday morning, during which the Perot representatives made numerous misrepresentations and omissions of material information and promises of improper benefits. The trustee also alleges that the NYSE, because of its own interest in preserving the capital of DGF Inc.,* concealed the conclusions of its own staff that Walston's capital would be completely depleted in eight months if the Perot Plan were adopted.

"* According to the trustee, the NYSE was interested in saving DGF Inc. because its liquidation would have made the Exchange Special Trust Fund liable to Perot on a $15 million note, and the Fund lacked funds sufficient to cover that amount" (4a-5a).

In the first six months of operation after the Perot Plan was implemented, Walston lost over $30 million and, as the NYSE had predicted, Walston was forced to liquidate its business. Arrangements were made in January, 1974 to dispose of the branch office network, and on March 27, 1974 Walston filed a petition for reorganization under Chapter XI of the Bankruptcy Act. On May 29, 1974 Walston was adjudicated a bankrupt and the Trustee was appointed.

Prior to the effectuation of the realignment agreements, Walston had equity of more than $30 million; at the time of its bankruptcy, it had assets of under $2 million against creditors' claims of over $75 million.

Based on "this sorry picture," the Trustee filed this suit in the United States District Court for the Southern District of New York on July 1, 1975 (5a, footnote omitted). On October 14, 1975 fifteen of the twenty defendants (the "Perot Group") moved for a stay pending arbitration.[1] Although the Trustee had not entered into any arbitration agreement, the Perot Group claimed that the Trustee was bound by arbitration agreements entered into by Walston, which designated tribunals from the NYSE or the American Stock Exchange, Inc. ("AMEX") as the arbitrators.

Nearly six months later, on April 12, 1975, the District Court granted the stay. Although recognizing that the stock exchange arbitration tribunals could not serve because of the appearance of bias, the district judge ruled that, unless the parties could agree otherwise, he would appoint the American Arbitration Association as the tribunal (15a-37a).

On January 25, 1977, the Second Circuit reversed (1a-14a). Writing for a unanimous court, Judge Feinberg concluded first that when a trustee sues to avoid fraudulent and preferential transfers under the Bankruptcy Act he stands in the shoes of creditors and is not subject to the arbitration agreements of the bankrupt:

> "These are statutory causes of action belonging to the trustee, not to the bankrupt, and the trustee asserts them for the benefit of the bankrupt's creditors, whose rights the trustee enforces. For example, if there had been no federal bankruptcy proceeding and if a creditor had independently asserted a claim under N.Y. Debt & Cred. Law § 278 to set aside a fraudulent transfer of assets the creditor would not have been subject to any arbitration agreement. Since the trustee stands in the creditor's shoes for this purpose, he too should not be compelled to arbitrate these claims" (9a; citations omitted).

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[1] The NYSE also moved for a stay pending arbitration, even though it admits it has no right to arbitration.

Second, the court concluded that the trustee's claims under the federal securities laws should not be arbitrated. The case concerns "one of the most celebrated brokerage house failures in the history of Wall Street" (10a; footnote omitted). The plaintiff is a bankruptcy trustee; unlike the usual corporate litigant, he employs no witnesses with knowledge of the facts and has few of the relevant records. At issue are federal statutes aimed at securities fraud. Under these circumstances, the policy of *Wilko* v. *Swan,* 346 U.S. 427 (1953), and its progeny in favor of determining securities laws disputes in court rather than in arbitration tribunals is fully applicable.

Although the Second Circuit had recognized a limited exception to the *Wilko* rule to permit arbitration of "intramural" disputes between stock exchange members in accordance with the self-regulatory policy set forth in Section 28(b) of the Securities and Exchange Act of 1934, that exception has no application to a "claim of wholesale fraud of institutional dimension, especially when raised by a trustee. . ." (12a).

Since the securities laws and Bankruptcy Act claims were not subject to arbitration, the Second Circuit held that the district court had erred in granting the stay.

DISCUSSION

The decision of the Second Circuit in this case is fully consistent with the decisions of this Court and of courts of appeals in other circuits. None of the questions of policy discussed in the petition and supporting brief actually arises in this case. None of the issues decided below is of sufficient importance to warrant review by this Court.

The Second Circuit's decision was an obviously correct resolution of an unusual fact situation; it did not announce a "nebulous" or "fluid" test which will multiply litigation in the federal courts; and there is no basis for imputing to it such disruptive consequences. Indeed, no trustee in bankruptcy has

ever been required to arbitrate a fraudulent or preferential transfer claim; no trustee in bankruptcy has ever been required to arbitrate a securities law claim; and no existing precedent is undercut by the decision below. In deciding this case, the Second Circuit left the law just where it found it. Accordingly, there is no basis for asking this Court to grant certiorari.

1. *There Is No Conflict With Any Decision Of This Court*

Petitioners claim that the decision below is in conflict with *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.,* 388 U.S. 395 (1967), a case involving only common law claims. They assert that *Prima Paint* holds that a court must grant a stay pending arbitration once the existence of an arbitration agreement is shown. However, this Court has recognized that arbitration of claims under federal statutes would in many situations be contrary to public policy and Congressional intent. *See Wilko* v. *Swan,* 346 U.S. 427 (1953) (Securities Act of 1933); *Alexander* v. *Gardner-Denver Co.,* 415 U.S. 36 (1974) (Title VII of the Civil Rights Act of 1964); *U.S. Bulk Carriers, Inc.* v. *Arguelles,* 400 U.S. 351 (1971) (seamen's wage law, 46 U.S.C. § 596).[2] The courts of appeals have reached similar conclusions in a number of cases arising under various federal statutes.[3] The *Prima Paint* case simply has no bearing on this case, which

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[2] *See also Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware,* 414 U.S. 117 (1973) (California Labor Code provision barring arbitration of wage claims not pre-empted by New York Stock Exchange arbitration rules promulgated as self-regulatory measures pursuant to Section 6 of the Securities Exchange Act of 1934). *Cf. Bernhardt* v. *Polygraphic Co.,* 350 U.S. 198, 203 (1956) (In a diversity case not involving interstate commerce, a federal court could not order arbitration if a state court would not, "[f]or the remedy by arbitration, whatever its merits or shortcomings, substantially affects the cause of action created by the State.")

[3] *See, e.g., Gutor International AG* v. *Raymond Packer Co.,* 493 F.2d 938 (1st Cir. 1974) (antitrust laws); *Greater Continental Corp.* v. *Schechter,* 422 F.2d 1100 (2d Cir. 1970) (Securities Exchange Act of 1934); *American Safety Equipment Corp.* v. *J.P. Maguire & Co.,*

alleges violations of no fewer than eight separate provisions of three federal statutes.

This Court has acknowledged that "[t]he nature of the tribunal where suits are tried is an important part of the parcel of rights behind a cause of action," and that a "change from a court of law to an arbitration panel may make a radical difference in ultimate result." *Bernhardt* v. *Polygraphic Co.*, 350 U.S. 198, 203 (1956). Accordingly, this Court has refused to enforce pre-existing arbitration agreements when disputes have arisen involving claims under federal statutes embodying significant federal policies.

The leading case on whether a plaintiff may be compelled to arbitrate federal statutory claims is *Wilko* v. *Swan*, where, as here, the plaintiff sought to recover for violations of the Securities Act of 1933. In holding that the non-waiver provision of Section 14 of the Securities Act[4] barred enforcement of

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391 F.2d 821 (2d Cir. 1968) (antitrust laws); *L.O. Koven & Brother, Inc.* v. *Steelworkers' Local 5767*, 381 F.2d 196 (3d Cir. 1967) (Bankruptcy Act); *Cobb* v. *Lewis*, 488 F.2d 41 (5th Cir. 1974) (antitrust laws); *Beckman Instruments, Inc.* v. *Technical Development Corp.*, 433 F.2d 55 (7th Cir. 1970), *cert. denied*, 401 U.S. 976 (1971) (patent law); *Helfenbein* v. *International Industries, Inc.*, 438 F.2d 1068 (8th Cir.), *cert. denied*, 404 U.S. 872 (1971) (antitrust laws); *A. & E. Plastic Pak Co.* v. *Monsanto Co.*, 396 F.2d 710 (9th Cir. 1968) (antitrust laws).

[4] Section 14, 15 U.S.C. § 77n, provides:

> "Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this title or of the rules and regulations of the Commission shall be void."

The Securities Exchange Act of 1934 contains a similar provision. Section 29(a) of the Securities Exchange Act, 15 U.S.C. § 78cc(a), provides:

> "Any condition, stipulation, or provision binding any person to waive compliance with any provision of this title or of any rule or regulation thereunder or of any rule of an exchange required thereby shall be void."

an arbitration agreement, this Court discussed the deficiences of the arbitration tribunal as a forum for resolution of federal securities law claims. Although the provisions of the Securities Act would apply in arbitration, their effectiveness would be "lessened in arbitration as compared to judicial proceedings":

> "This case requires subjective findings on the purpose and knowledge of an alleged violator of the Act. They must be not only determined but applied by the arbitrators without judicial instruction on the law. As their award may be made without explanation of their reasons and without a complete record of their proceedings, the arbitrators' conception of the legal meaning of such statutory requirements as 'burden of proof,' 'reasonable care' or 'material fact' . . . cannot be examined. Power to vacate an award is limited. . . . As the protective provisions of the Securities Act require the exercise of judicial direction to fairly assure their effectiveness, it seems to us that Congress must have intended § 14 . . . to apply to waiver of judicial trial and review." 346 U.S. at 435-37 (footnotes omitted).

The instant action is even less suited to arbitration than *Wilko*. Here, the unavailability of ordinary pretrial discovery—a deficiency of arbitration recently noted by this Court in *Alexander* v. *Gardner-Denver Co.*[5]—assumes greater than usual significance because the plaintiff is a trustee in bankruptcy. His access to evidence through informal means outside the court process is more limited than that of an ordinary litigant. As the Second Circuit stated:

> "Unlike an operating business, the trustee employs no witnesses with knowledge of the relevant facts, and he has almost none of the relevant records" (10a).

Accordingly, a bankruptcy trustee has particular need for discovery available in federal courts but not in arbitration.

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[5] 415 U.S. 36, 57-58 (1974).

Following the lead of *Alexander* v. *Gardner-Denver Co.*, the court below cited the Trustee's need for discovery as an additional reason for denying arbitration.

The court below drew its decisional principles from the relevant precedents of this Court and correctly decided the case before it. Instead of attacking the result reached in this case, petitioners have selected phrases from the opinion below, characterized them as the holdings of the court, and predicted for them a potential for mischief in other cases. Petitioners assert that the Second Circuit announced a "nebulous three-pronged test" requiring a "case-by-case" analysis which portends "expanded proceedural litigation" in the future (Petition 8, 10, 12). When the issue before the Second Circuit and the result reached are examined, it is clear that the decision below simply is not the reckless venture into uncharted waters which petitioners call it.

All that the court below was called upon to do was to apply to the Trustee's securities law claims either the well-established rule of *Wilko* v. *Swan* or a limited exception to that rule recognized in other Second Circuit cases. After analyzing the relevant statutes and policy considerations, the Second Circuit found that this Court's *Wilko* rule was applicable. Far from reaching a result inconsistent with a decision of this Court, the Second Circuit followed the controlling Supreme Court precedent. Petitioners' argument that the opinion below is in conflict with the obviously irrelevant *Prima Paint* case[6] demonstrates clearly the lack of merit in the petition.

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[6] While placing their principal reliance on *Prima Paint*, Petitioners half-heartedly claim that the decision below is also inconsistent with *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506 (1974). The claim is specious. A footnote to the *Scherk* majority opinion observed that one of the parties had argued that *Wilko* v. *Swan* should be given a narrow reading, but stated that the Court did not have to consider the argument because of its disposition of the case on other grounds.

2. There Is No Conflict With A Decision Of Another Circuit

The petition states that the decision below is in conflict with the First Circuit's decision in the *Revenue Properties Litigation Cases*, 451 F.2d 310 (lst Cir. 1971). However, the court in *Revenue Properties* reached the same result as a line of Second Circuit cases which the Second Circuit cited and distinguished in its opinion below.

Unlike the present action, all of these cases involved disputes between fellow stock brokers over a transaction in a publicly traded security in which they had participated in the ordinary course of their business. *See, e.g., Axelrod & Co.* v. *Kordich, Victor & Neufeld*, 451 F.2d 838 (2d Cir. 1971); *Brown* v. *Gilligan, Will & Co.*, 287 F. Supp. 766 (S.D.N.Y. 1968). *See also Coenen* v. *R.W. Pressprich & Co.*, 453 F.2d 1209 (2d Cir.), *cert. denied*, 406 U.S. 949 (1972) (plaintiff joined stock exchange after transaction at issue). Such routine intramural disputes have been held subject to arbitration even where charges of securities fraud are made because of the belief that arbitration under stock exchange auspices may assist in maintaining good relations between exchange members. As the Second Circuit stated in *Coenen, supra,*

> "the common, garden variety of alleged scheme to defraud in a security transaction . . . is precisely the sort of breeder of ill-feeling between members of the Exchange it was intended to keep out of the courts." 453 F.2d at 1215.

Here, in contrast, the plaintiff is not a member of any exchange but a statutorily created representative of creditors; the case does not involve a run of the mill securities trade but "a claim of wholesale fraud of institutional dimension" resulting in the destruction of one of the largest securities firms in the country; and the New York Stock Exchange is not standing by as a neutral arbiter ready to mediate the dispute, but is a named defendant, charged with having a financial interest in the

transaction and with participating actively in the misconduct alleged. Thus, the Second Circuit reached a different result from *Revenue Properties,* not because it regarded the case as wrongly decided, but because it found material distinctions between the facts of that case and the facts of this one.

The same facts which distinguish this case from *Revenue Properties* also make it clear that the public policy arguments advanced by the NYSE against the decision below simply do not apply to this case. The NYSE asserts that the issue in this case is whether arbitration of disputes between NYSE *members* involving allegations of securities law or Bankruptcy Act violations may be required. Yet this dispute is between a bankruptcy trustee and twenty defendants, none of which is presently a member of the NYSE. The NYSE characterizes the decision below as an erosion of the self-regulatory process. Yet the self-regulatory authority is itself a defendant in the suit and has been disqualified from mediating the dispute. The NYSE argues that arbitration would further the goal of fostering harmonious relations between NYSE members. Yet none of the parties to the case is an NYSE member. And the NYSE states that experts from the industry would do a better job of trying this case than a federal court. Yet the arbitrators in this case could not have been drawn from the exchanges.

In a proper case, the NYSE's arguments might have been entitled to some weight, but they are quite beside the point under the circumstances presented here. There is no legitimate self-regulatory policy which would warrant "muffling" this dispute "in the cloakroom of arbitration." *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware,* 414 U.S. 117, 136 (1973).

3. *No Significant Issue Of Bankruptcy Law Was Decided Below*

Seizing upon the statement in the opinion below that "[t]his case raises significant questions regarding the interplay between the powers of a bankruptcy trustee and the United States Arbitration Act . . ." (3a), petitioners leap to the con-

clusion that the Second Circuit has decided an important question of bankruptcy law which should be considered by this Court. Petitioners have confused the issues raised below with the issues actually decided by the court of appeals. Noting that the parties' arguments raised "a number of substantial questions," the Second Circuit found it "not . . . necessary to consider most of them" (8a; footnote omitted).

The Second Circuit never even reached the issue petitioners raise here of whether a trustee is bound by the bankrupt's arbitration agreements when he brings suit as successor to the bankrupt.[7] The Trustee is suing not only on claims which had been owned by the bankrupt prior to bankruptcy but also on claims which had been owned by the bankrupt's creditors. The Second Circuit's opinion considered the effect of the Bankruptcy Act only on claims in which the Trustee asserts the rights of creditors.

The claims of these creditors are set forth in seven counts of the complaint which seek recovery of voidable preferences and fraudulent transfers under Sections 60, 67 and 70 of the Bankruptcy Act. When a trustee in bankruptcy sues upon claims such as these, he is standing in the shoes of creditors and has all

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[7] Even if the Second Circuit had placed its decision for the Trustee on this ground, petitioners would have had no basis for seeking this Court's review. Petitioners' claim that the Trustee would be bound to carry out such agreements has no support in precedent or logic. Section 70b of the Bankruptcy Act, 11 U.S.C. § 110(b), relieves the trustee from any obligation to perform executory contracts of the bankrupt unless he has specifically elected to assume them. The courts which have considered the question uniformly have ruled that a trustee or debtor-in-possession may not be required to perform the arbitration clause in a contract that has been rejected or disaffirmed under the Bankruptcy Act. *See Johnson* v. *England,* 356 F.2d 44 (9th Cir.), *cert. denied,* 384 U.S. 961 (1966); *In re Muskegon Motor Specialties Co.,* 313 F.2d 841 (6th Cir.), *cert. denied,* 375 U.S. 832 (1963); *Local 30, ILGWU* v. *Hers Apparel Industries, Inc.,* 76 CCH Lab. Cas. ¶10,733 (S.D.N.Y. 1975) (not officially reported); *Allegaert* v. *Mendiburu,* F-75-36-Civil (E.D. Cal. 1975) (not officially

their rights and powers; defenses which would have been good against the bankrupt but not against its creditors will not bar the trustee's recovery. *See, e.g., Buttrey* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 410 F.2d 135 (7th Cir.), *cert. denied*, 396 U.S. 838 (1969); *Schneider* v. *O'Neal*, 243 F.2d 914 (8th Cir. 1957). Since a creditor suing a transferee could not be forced to arbitrate on the basis of an arbitration agreement between the transferee and the bankrupt, neither can the trustee be forced to arbitrate when he is standing in the shoes of creditors under Sections 60, 67 and 70 of the Bankruptcy Act. *See Johnson* v. *England*, 356 F.2d 44 (9th Cir.), *cert. denied*, 384 U.S. 961 (1966).

Having found that most of the claims in the complaint—the Bankruptcy Act and securities laws counts—were not arbitrable, the Second Circuit concluded that the case

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reported). *See also Knickerbocker Agency* v. *Holz*, 4 N.Y.2d 245, 173 N.Y.S.2d 602, 149 N.E.2d 885 (1958).

The cases cited by petitioners lend no support to their position. Thus, petitioners mis-cite *Bank of Marin* v. *England*, 385 U.S. 99 (1966), for the proposition that a trustee is "bound" by the contracts of the bankrupt. This is true only in the sense that the trustee must recognize a claim for breach of contract in determining what claims against the estate are allowable; the case nowhere states or implies that a trustee must specifically perform the bankrupt's contracts. Similarly, petitioners mis-cite *Truck Driver's Local 807* v. *Bohack Corp.*, 541 F.2d 312 (2d Cir. 1976), for the proposition that a bankruptcy trustee may not "unilaterally" disavow the bankrupt's arbitration contract. That case involved a Chapter XI debtor-in-possession. Unlike a trustee in bankruptcy, a debtor-in-possession must obtain bankruptcy court approval in order to reject any executory contract. *See* Bankruptcy Act § 313(1), 11 U.S.C. § 713(1); Bankruptcy Rule 11-53. In a straight bankruptcy proceeding, the trustee may reject or disaffirm executory contracts without any court approval whatever. *See* Bankruptcy Act § 70b, 11 U.S.C. § 110(b); Bankruptcy Rule 607. Here, it is quite clear that the Trustee rejected all of the contracts at issue, so there is no basis for requiring him to perform the arbitration clauses in them.

should proceed in federal court without deciding whether the remaining counts standing alone would have warranted a stay pending arbitration. Thus, the question whether a trustee would be bound by a bankrupt's arbitration agreement when suing on a state law claim inherited from the bankrupt is not presented by this record. The Second Circuit decided the case on independent grounds fully supported by reason, precedent, and statute.

CONCLUSION

It is respectfully submitted that the petition for a writ of certiorari should be denied.

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May, 1977

Supreme Court, U. S.
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76-1478

IN THE

Supreme Court of the United States

October Term, 1976

No. _____

H. ROSS PEROT, ELECTRONIC DATA SYSTEMS CORPORATION, DUPONT GLORE FORGAN INCORPORATED, WILLIAM K. GAYDEN, MORTON H. MEYERSON, MILLEDGE A. HART, III, MARGOT PEROT, MERVIN L. STAUFFER, PHM & CO., CHARLESTON INVESTMENT COMPANY, E. D. SYSTEMS CORPORATION, DANIEL J. CULLEN, WILLIAM D. FLEMING, GEORGE T. THOMSON AND CHARLES W. COX,

Petitioners,

—against—

WINTHROP J. ALLEGAERT, as Trustee of duPont Walston Incorporated,

Respondent,

—and—

NEW YORK STOCK EXCHANGE, INC., DOUGLAS E. DETATA, JOHN J. DOUGHTY, ALLAN BLAIR, AND D. TIPP CULLEN,

Additional Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF OF RESPONDENT NEW YORK STOCK EXCHANGE, INC. IN SUPPORT OF PETITION

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IN THE

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Petitioners,

—against—

WINTHROP J. ALLEGAERT, as Trustee of duPont Walston Incorporated,

Respondent,

—and—

NEW YORK STOCK EXCHANGE, INC., DOUGLAS E. DETATA, JOHN J. DOUGHTY, ALLAN BLAIR, AND D. TIPP CULLEN,

Additional Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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BRIEF OF RESPONDENT NEW YORK STOCK EXCHANGE, INC. IN SUPPORT OF PETITION

Opinions Below

The opinion of the United States District Court for the Southern District of New York is reproduced in the petition at Appendix B. The opinion of the United States Court of Appeals for the Second Circuit, reported at 548 F.2d 432, is reproduced in the petition at Appendix A.

Jurisdiction of the Court

The Court's jurisdiction is invoked under 28 U.S.C. § 1254(1). The judgment sought to be reviewed was entered on January 25, 1977.

Question Presented

A question presented, vital to all national securities exchanges, is whether arbitration of exchange members' disputes, required by exchange constitutions and rules, can be compelled in disputes involving claims arising under the federal securities laws and the Bankruptcy Act. The Court below held that, except for "mere internal brokerage industry squabble[s]," such arbitration cannot be compelled.

Statutes and Rules Involved

This case involves Sections 2 and 3 of the United States Arbitration Act (9 U.S.C. §§ 2 and 3); Sections 26, 60b, 67d, and 70e of the Bankruptcy Act (11 U.S.C. §§ 49, 96b, 107d, and 110e); Section 14 of the Securities Act of 1933 (15 U.S.C. § 77n); Sections 6, 10(b), 19, 28(b), and 29(a) of the Securities Exchange Act of 1934 (15 U.S.C. §§ 78f, 78j(b), 78s, 78bb(b), and 78cc(a)); Securities and Exchange Commission Rule 10b-5 (17 C.F.R. 240.10b-5); and Bankruptcy Rule 919(b).

Statement of the Case

The case is well stated in the petition. This brief deals with the role of New York Stock Exchange, Inc. (the "Exchange") in the case and the effect of the decision below on national securities exchanges and the principle of self-regulation embodied in the Securities Exchange Act of 1934 ("Exchange Act").

Respondent, the trustee (the "Trustee") of duPont Walston Incorporated ("Walston"), named the Exchange

as a defendant, charging it with conspiring with the other defendants to defraud Walston and with violating the Exchange's regulatory duties under Section 6 of the Exchange Act in connection with the realignment in July 1973 of the businesses of Walston and duPont Glore Forgan Incorporated, then two of the Exchange's largest member organizations.

In the District Court, petitioners moved to stay the action pending arbitration. The Exchange is not a party to any arbitration agreement and therefore could not join in petitioners' motion. However, the Exchange did move to stay the action as to it on the ground that arbitration between the Trustee and the petitioners would resolve many of the issues pertaining to the Exchange and might render the action moot. The Exchange argued that a denial of its motion would result in duplicative effort with a consequent waste of time and money for the Court and parties and would create the possibility of inconsistent results.

Judge Knapp granted the Exchange's motion, staying the action as to the Exchange and the four non-moving defendants pending conclusion of arbitration, which he directed be held between petitioners and the Trustee.

The Trustee appealed. The Court below reversed, holding that the Trustee should proceed in the District Court with his Bankruptcy Act and securities laws claims. Noting that these claims "involve so many of the basic factual and legal issues underlying the [T]rustee's remaining claims," the Court below suggested that none of the Trustee's claims be permitted to proceed to arbitration.

The Court below held that the order staying the action against the Exchange was interlocutory and not appealable. It observed, however, that it would be an abuse of the District Court's discretion to continue the stay in view of the Court of Appeals' decision precluding arbitration.

Reasons for Granting the Writ

I. THE DECISION BELOW UNDERMINES EXCHANGE SELF-REGULATION AS CONTEMPLATED BY THE EXCHANGE ACT AND AS PRACTICED BY NATIONAL SECURITIES EXCHANGES.

While the purpose of the Exchange Act was to establish a comprehensive regulatory scheme for the securities industry, "[t]he pattern of governmental entry . . . was by no means one of total displacement of the exchanges' traditional process of self-regulation." *Silver* v. *New York Stock Exchange,* 373 U.S. 341, 352 (1963). *See also Gordon* v. *New York Stock Exchange, Inc.,* 422 U.S. 659, 663-67 (1975). Rather, the Exchange Act imposed a scheme of "supervised self-regulation," which "involves control of exchange markets by requiring or permitting national securities exchanges to adopt rules governing their practices and procedures and the business conduct of their members, and in each case imposes the responsibility for enforcement of these rules on the exchanges themselves." SEC, Report of Special Study of Securities Markets, H. R. Doc. No. 95, 88th Cong., 1st Sess., Pt. 1 at 3 (1963). "Instead of giving the Commission the power to curb specific instances of abuse, the Act placed in the exchanges a duty to register with the Commission . . . and decreed that registration could not be granted unless the exchange submitted copies of its rules, . . . and unless such rules were 'just and adequate to insure fair dealing, and to protect investors'. . . ." *Silver* v. *New York Stock Exchange, supra* at 352.

In implementing the Congressional policy of exchange self-regulation, the Exchange's Constitution, Article VIII, § 1, provides:

> "Any controversy between parties who are members, allied members, member firms or member corporations shall, at the instance of any such party, and any controversy between a non-member and a member or allied member or member firm or member corporation arising out of the business of such member, allied member, member firm or member corporation, or the dissolution of a member firm or member corporation, shall, at the instance of such non-member, be submitted for arbitration, in accordance with the provisions of the Constitution and the rules of the Board of Directors." (2 NYSE Guide (CCH) ¶ 1351)

This provision, which by its terms reaches "any controversy" and, specifically, claims arising out of the "dissolution of a member firm," comprehends the Trustee's claims. Similar provisions are found in the constitutions and rules of other national securities exchanges.* "[E]very member, by virtue of his admission, contracts to be governed by the conditions of membership which the exchange has imposed. These conditions are, therefore, binding on the members, and constitute virtually a body of law by which the members are governed in their dealings with the exchange and with each other." *Brown* v. *Gilligan, Will & Co.,* 287 F.Supp. 766, 769 (S.D.N.Y. 1968), *quoting* C. H. Meyer, The Law of Stock Brokers and Stock Exchanges § 7 (1931).

Moreover, the authority of exchanges to provide for settlement of their members' disputes is given express recognition in Section 28(b) of the Exchange Act, 15 U.S.C. § 78bb(b), which provides:

> "Nothing in this chapter shall be construed to modify existing law with regard to the binding effect . . . on any member of or participant in any self-regulatory organization of any action taken by the authorities of such organization to settle disputes between its members or participants. . . ."

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* *See, e.g.,* American Stock Exchange Constitution, Art. VIII, 2 Am. Stock Ex. Guide (CCH) ¶ 9062; Boston Stock Exchange Constitution, Art. IX, § 3, Boston Stock Ex. Guide (CCH) ¶ 1203; Pacific Stock Exchange Constitution, Art. XII, §§ 1, 2, Pacific Coast Stock Ex. Guide (CCH) ¶¶ 1801, 1806.

Here, petitioners and Walston qualify as those entitled to compel arbitration of each other's claims. Petitioners moved to compel arbitration. The District Court granted the motion. The Court below reversed. The effect of the decision below is to limit the disputes as to which arbitration can be compelled to "mere internal brokerage industry squabble[s]." Not only does this limitation seriously erode an important aspect of self-regulation, but the standard prescribed by the decision below leaves future disputants in a quandary over whether their dispute is a "mere . . . industry squabble" or "of a character inappropriate for arbitration."

There are advantages to arbitration, whether the controversy is individual or institutional in nature. Arbitration is a much quicker method of settling disputes. Prompt settlement of disputes furthers an exchange's interest in fostering harmonious relations between its members. Arbitration also is less expensive. The immediate beneficiaries of reduced costs are the parties themselves. Ultimately, however, these savings in the cost of doing business are passed along to the investing public.*

Furthermore, disputes in the securities industry may involve complicated concepts and terminology unique to the industry, as does this case. The thrust of the Trustee's claims is that the net capital, financial, and record-keeping condition of the duPont firm at the time of the realignment was not as it had been represented to Walston. An analysis of those aspects of the condition of the duPont firm requires the ability to comprehend highly technical ingredients of brokerage accounting and record-keeping. For this reason, arbitration before a panel knowledgeable in the

* The Exchange subsidizes the arbitration which it sponsors. Parties to arbitration presently are taxed between $350 and $550 per session. To the extent that costs exceed this levy, the Exchange makes up the difference. Exchange Rule 482, 2 NYSE GUIDE (CCH) ¶ 2482. For 1977 the Exchange has budgeted approximately $450,000 in support of its arbitration facility, approximately the same amount which it expended in each of the three previous years for that purpose.

intricacies of the securities industry is superior to protracted litigation in the federal courts.* Resoluton of disputes by persons familiar with the industry also would eliminate the costly and time-consuming need to "educate" a jury.

If a dispute between exchange members raises important questions of social policy or requires corrective action on behalf of interests not adequately represented in a private arbitration proceeding—both concerns of the Court below—then the Exchange Act provides ample authority for separate, public proceedings by or under the auspices of the SEC.**

Nevertheless, the Court below cited unarticulated "public policy" reasons which amounted to the proposition that arbitration is inappropriate in this case because it is a case involving broad questions of policy and that somehow the machinery of arbitration is not adequate to cope with such cases. This concern previously had been considered and rejected by the Court of Appeals for the First Circuit in *In Re the Revenue Properties Litigation Cases (Cohn, Delaire & Kaufman)*, 451 F.2d 310, 313-14 (1st Cir. 1971):

> "[White, Weld] points out that if it is compelled to arbitrate, issues important to the securities industry could be decided, with only the limited review envisaged by 9 U.S.C. § 10. The logic of this argument implies a prerequisite to arbitrability: that only issues not heavily invested with legal significance be decided. But no area of arbitration is guaranteed to be kept insulated from important issues of substantive law. A labor-management arbitration agreement could not be imagined to contain the caveat, 'except when an important or novel construction of the National Labor-

* For much the same reason, this Court recently endorsed arbitration in the context of a labor-management dispute. *Nolde Bros., Inc.* v. *Local No. 358, Bakery &Confectionery Workers Union*, 97 S. Ct. 1067, 1073 (1977).

** *See* Exchange Act, Sections 19, 21, 22, 23, and 25 (15 U.S.C. §§ 78s, 78u, 78v, 78w, and 78y).

> Management Relations Act is involved'. . . . If, under 15 U.S.C. § 78j(b), for example, the cause of action—use of a deceptive device violative of the rules of an exchange—is suitable for arbitration, as we would most certainly think it is, we would not know where to draw the line beyond which arbitration—with all its benefits and all its risks—could not take place."

The decision of the Court below, limiting the availability of arbitration to certain ill-defined "intramural situations," also gives rise to the anomalous result that public investors who seek arbitration of their claims may be thwarted by exchange members who contend in federal court, *e.g.*, that theirs is a dispute raising questions under the federal securities laws or "rais[ing] broad questions of policy which ordinarily should be handled by the judiciary." Thus, under the fluid "appropriateness" test promulgated by the Court below, members of the public could be denied the speedy and inexpensive determination of their disputes afforded by arbitration, which they are entitled to compel under the constitutions and rules of exchanges.* Indeed, seven of the petitioners are nonmembers of the Exchange who seek speedy and inexpensive resolution of their dispute arising out of their dealings with a member organization.

There is nothing in the record or in the circumstances of this case to suggest that arbitration is inappropriate to resolve the Trustee's claims. Arbitration has successfully resolved in the past many cases "rais[ing] broad questions of policy," and there is no basis for the belief that here arbitration procedures will prove inadequate or that the arbitrators will be unfair. This case exhibits no special circumstances to warrant the result reached below. The arbitration agreements which the Trustee would avoid were

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* Between 1974 and 1976, inclusive, Exchange arbitration panels processed 879 new cases and concluded 975 cases. Of the cases concluded, 490 involved a dispute between a member of the public and a member of the Exchange community.

freely entered into by experienced and sophisticated brokers from two of the Exchange's largest member organizations who had full knowledge of the consequences of their actions and eminent legal counsel. Walston (and its successor in interest, the Trustee) requires no special dispensation from its commitment to arbitrate.

Unlike *American Safety Equipment Corp.* v. *J. P. Maguire & Co.*, 391 F.2d 821 (2d Cir. 1968), from which the Court below adopted its three-pronged "appropriateness" test, this case does not involve claims based on "contracts of adhesion between alleged monopolists." (391 F.2d at 827) The Exchange's Constitution and Rules and those of the American Stock Exchange have been reviewed and approved by the SEC. Walston was required to subscribe to the Exchange's arbitration requirement as a condition of Exchange membership. That requirement is recognized by the Exchange Act and has been approved by the SEC as part of the comprehensive regulatory scheme, which should not be judicially dismantled.

Adoption of the "appropriateness" test by the Court below will undermine the effectiveness of countless arbitration agreements and undoubtedly will require the attention of the federal courts on a case-by-case basis. Under the decision below, not only will cases "inappropriate" for arbitration be brought to the federal courts, but also those cases in which the broker opposing arbitration can raise a colorable argument of inappropriateness. Claims of fraud under the federal securities laws will be pleaded to avoid arbitration of ordinary brokerage and corporate transactions subject to arbitration clauses. The transaction attacked in this suit is not unusual. Brokerage firms are continually merging or realigning their businesses. Unfortunately, brokerage firms often go bankrupt, too. Avoidance of arbitration clauses via the route mapped out by the decision below has no basis in any act of Congress and furthers no federal interest. On the contrary, it will frustrate the Congressional policy embodied in both the Exchange Act and the Arbitration Act, and needlessly increase

the caseload of an overburdened federal court system with cases that always have been well handled by arbitration within the securities industry.

II. THE DECISION BELOW FINDS NO SUPPORT IN ANY STATUTE OR IN ANY DECISION OF THIS COURT.

The decision of the Court of Appeals below deviates from the general rule that arbitration of exchange members' disputes, required by the constitutions and rules of exchanges, is binding and will be enforced by the courts. Point II, sections A and B of the petition well set forth and discuss the authorities. Those sections are adopted by reference.

CONCLUSION

The petition should be granted because of the damage the decision below will work on self-regulation as contemplated by the Exchange Act and as practiced by national securities exchanges. Upon review, the decision below should be reversed.

Respectfully submitted,

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April 25, 1977

Supreme Court, U. S.
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MICHAEL RODAK, JR., CLERK

IN THE

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Additional Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

REPLY BRIEF OF RESPONDENT NEW YORK STOCK EXCHANGE, INC. IN SUPPORT OF PETITION

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October Term, 1976

No. 76-1478

H. ROSS PEROT, ELECTRONIC DATA SYSTEMS CORPORATION, duPONT GLORE FORGAN INCORPORATED, WILLIAM K. GAYDEN, MORTON H. MEYERSON, MILLEDGE A. HART, III, MARGOT PEROT, MERVIN L. STAUFFER, PHM & Co., CHARLESTON INVESTMENT COMPANY, E. D. SYSTEMS CORPORATION, DANIEL J. CULLEN, WILLIAM D. FLEMING, GEORGE T. THOMSON AND CHARLES W. COX,

Petitioners,

—against—

WINTHROP J. ALLEGAERT, as Trustee of duPont Walston Incorporated,

Respondent,

—and—

NEW YORK STOCK EXCHANGE, INC., DOUGLAS E. DeTATA, JOHN J. DOUGHTY, ALLAN BLAIR, AND D. TIPP CULLEN,

Additional Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

---

REPLY BRIEF OF RESPONDENT NEW YORK STOCK EXCHANGE, INC. IN SUPPORT OF PETITION

The Trustee's brief in opposition discounts the Exchange's arguments in support of the petition because neither the Trustee nor any of the twenty defendants presently is a member of the Exchange. However, this observation is beside the point. The Trustee stands in the shoes

of a former Exchange member. Similarly, nearly all of the defendants are former Exchange members or members of the Exchange community entitled to demand arbitration under the Exchange's Constitution and Rules. Each *in his present status* is bound by one or more separate agreements to arbitrate. That none of the parties presently is a member of the Exchange does not alter this fact. The holding of the Court below does not deny arbitration only in cases where the parties are not current members of the Exchange; rather, the decision limits arbitration to "mere . . . industry squabble[s]" regardless of the membership status of the disputants at the time of resolution. (App. A, p. 12a)

The Trustee also suggests that erosion of the important role of national securities exchanges in the regulatory scheme of the Exchange Act should be permitted in cases in which an exchange is named a defendant. Such reasoning contains the potential for abuse (*i.e.*, name an exchange a defendant and avoid arbitration).

The Exchange's status as a defendant should not trigger repudiation of the salutary principle of resolving intra-industry disputes by arbitration before arbitrators knowledgeable in the securities business as contemplated by the self-regulatory scheme. The Exchange does not provide the only forum for arbitration. The Court of Appeals did not speak to the composition of the arbitration panel. The defendants in the District Court acknowledged that arbitration "should not be held under NYSE auspices" (App. B, p. 26a), and the District Court explicitly provided:

> "So as to avoid even the appearance of bias which designation of the Amex might engender, the parties are directed to agree among themselves upon the appropriate arbitration tribunal, in default of which, the Court will, in accordance with the spirit of the Amex constitution, designate the American Arbitration Association." (App. B, p. 34a)

The Trustee's argument that the arbitrators "could not have been drawn from the exchanges" (Br., p. 12), therefore, is incorrect. The Exchange and Amex are precluded as arbitration *forums*. The expertise of individual members of the exchange communities is not precluded. Arbitration as ordered by the District Court would permit a panel of arbitrators to be selected by the parties from the community of either or both exchanges (or NASD or any other exchange), or for such arbitrators to be named to an American Arbitration Association panel. Thus, the benefits of arbitration discussed in the Exchange's main brief (pp. 6-7), as contemplated by Exchange Act § 28(b), could be realized.

CONCLUSION

The petition should be granted and, upon review, the decision below should be reversed.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

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v.

WINTHROP J. ALLEGAERT, as Trustee of duPont Walston Incorporated, *Respondent,*

- and -

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On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

June 2, 1977

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WINTHROP J. ALLEGAERT, as Trustee of duPont Walston Incorporated, *Respondent,*

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NEW YORK STOCK EXCHANGE, INC., DOUGLAS E. DeTATA, JOHN J. DOUGHTY, ALLAN BLAIR and D. TIPP CULLEN, *Additional Respondents.*

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

Pursuant to Rules 24(4) and 24(5), Petitioners[1] submit this Reply in support of their Petition for a

[1] Petitioners, all of whom are named defendants in this action, are H. Ross Perot, Electronic Data Systems Corporation, duPont Glore Forgan Incorporated, William K. Gayden, Morton H. Meyerson, Milledge A. Hart, III, Margot Perot, Mervin L. Stauffer, PHM & Co., Charleston Investment Company, E. D. Systems Corporation, Daniel J. Cullen, William D. Fleming, George T. Thomson and Charles W. Cox.

Writ of Certiorari to the United States Court of Appeals for the Second Circuit, docketed with the Court on April 25, 1977. The first section of this Reply will discuss the decision of the Fifth Circuit Court of Appeals in *Tullis* v. *Kohlmeyer & Co.*, 551 F.2d 632 (1977), which opinion was issued after the filing of the initial certiorari petition herein and which is squarely in conflict with the decision of the Second Circuit Court of Appeals in the instant case. The second section of this Reply addresses several of the Respondent's[2] contentions with respect to arbitrability of his securities laws claims which present matters not addressed in the initial Petition. The third section of this Reply addresses Respondent's contention that the court below—despite its own statement to the contrary—decided no issues of significance under the Bankruptcy Act.[3]

ARGUMENT

I. The Decision Below Directly Conflicts With a Decision of the Fifth Circuit Interpreting Section 28(b) of the Exchange Act.

Subsequent to the filing of the initial Petition, the United States Court of Appeals for the Fifth Circuit issued its decision in *Tullis* v. *Kohlmeyer & Co.*, 551 F.2d 632 (1977) (hereinafter "*Tullis*"). This decision is in direct conflict with the decision below, thus

[2] Respondent is Winthrop J. Allegaert, the trustee in bankruptcy of duPont Walston Incorporated (hereinafter "Allegaert" or "Respondent").

[3] Petitioners will not respond in this Reply to Allegaert's "Statement of the Facts," which merely summarizes the unproven allegations in his Complaint. Suffice it to say that they vigorously dispute all allegations of wrongdoing. In any event, such allegations are not relevant for purposes of determining Petitioners' right to arbitration under the United States Arbitration Act.

providing an important additional[4] reason for granting certiorari, and further illustrates the Second Circuit's misapplication of the governing statutory provisions and precedent in the instant case.

Tullis, like this case, involved the question of whether disputes arising under the Federal securities laws among members of the national securities exchanges may be arbitrated pursuant to the mandatory arbitration provisions of the exchange Constitutions. The Fifth Circuit held that such disputes are clearly arbi-

[4] As noted in the initial Petition herein, the decision of the court below also directly conflicts with the First Circuit's decision in *In Re Revenue Properties Litigation Cases* (*Cohn, Delaire & Kaufman*), 451 F.2d 310 (1971) (hereinafter "*Revenue Properties*"). See Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit (hereinafter "Pet."), pp. 16-18.

Allegaert argues that the decision below does not conflict with the First Circuit's decision in *Revenue Properties*, because *Revenue Properties* (a case which the Court of Appeals below ignored in its opinion even though it had been cited to the court by the Petitioners) reached the "same result" as a line of Second Circuit cases which the court below cited and attempted to distinguish. Allegaert ignores entirely, however, the First Circuit's clear, plain holding in *Revenue Properties* that the rule in *Wilko* v. *Swan*, 346 U.S. 427 (1953), simply does not apply when arbitration is sought pursuant to the arbitration provisions of an exchange constitution, because § 14 of the Securities Act of 1933, the statutory provision on which *Wilko* was based, by its terms does not apply in cases (such as in *Revenue Properties* and here) where the arbitration agreements were not entered into in connection with the acquisition of any security. *Revenue Properties, supra,* 451 F.2d at 313. Nor does it matter whether the claim under the Federal securities laws arises out of market transactions (as in *Revenue Properties*) or out of an investment in a brokerage house as Allegaert argues. *Tullis* involved a claim of securities fraud in connection with an investment in an exchange member firm. *See also,* Bankruptcy Judge Babitt's decision in *In the Matter of Blair* (Danford), No. 70 B 755 (S.D.N.Y. June 1, 1973) (App. F, pp. 97a-112a), which was cited in the court below by the Petitioners.

trable, without regard to the type of transaction out of which the claims arose. It based its holding squarely upon Section 28(b) of the Securities Exchange Act of 1934, 28 U.S.C. § 78bb(b). This decision is thus in direct conflict with the decision below which, for the first time, held that the provisions of the Constitutions of the national securities exchanges compelling arbitration of disputes among members (and among members and non-members at the insistence of the latter) could be enforced only with respect to "intramural transactions" or "mere internal brokerage industry squabble[s]," and would not be enforced when such disputes presented "institutional" fraud claims arising under the Federal securities laws. (App. A., pp. 11a-12a.)

Plaintiffs in *Tullis,* like Allegaert (the plaintiff here), had argued that arbitration of their securities law claims was barred under this Court's decision in *Wilko* v. *Swan,* 346 U.S. 427 (1953) (hereinafter "*Wilko*") and further argued that the exception to *Wilko* for exchange member disputes did not apply to their case, because it involved an investment by plaintiffs in Kohlmeyer & Co., a defunct brokerage firm in liquidation as of the time of the lawsuit.

Reviewing the long line of cases which had uniformly held that the exchange arbitration provisions are exempt from the non-waiver rule articulated in *Wilko,* the Fifth Circuit found that "the statutory and policy underpinnings" of these decisions were "sound" 551 F.2d at 638. The Fifth Circuit expressly endorsed the First Circuit's decision in *Revenue Properties.* 551 F.2d at 637. The Fifth Circuit noted that in *Wilko* this Court "had no occasion to consider the effect of § 28(b) on the non-waiver provisions." 551 F.2d at 636. When arbitration is sought against a member of

an exchange, "§ 28(b) is applicable and overrides the nonwaiver provisions which were the basis of *Wilko.*" *Id.* There is thus "little reason for the holding in *Wilko* v. *Swan* to be extended beyond cases involving ordinary investors to those between stock exchange members."[5] 551 F.2d 638.

Further, the court held, the type of transaction involved:

> "has no more relevance in determining whether arbitration is proper . . . than . . . in determining whether the substantative principles of the 1933 and 1934 Acts apply." 551 F.2d at 636.

Plaintiffs' membership in the exchange "took them beyond the realm of the ordinary investor" regardless of whether they were "outsiders" or "insiders" with respect to the transaction at issue.[6] 551 F.2d at 638. The "critical issue" is simply whether the party seek-

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[5] The Fifth Circuit also quoted Justice Stevens' dissent in *Alberto-Culver Co.* v. *Scherk,* 484 F.2d 611, 615-618 (7th Cir. 1973), *rev'd,* 417 U.S. 506 (1974), which noted that "in the two decades since the Supreme Court considered the collision between the two conflicting policies which made *Wilko* v. *Swan* such a close case," the policy of resolving disputes by arbitration had received "increasingly strong endorsement," citing, *inter alia, Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.,* 388 U.S. 395 (1967).

[6] Prior cases consistently have upheld exchange arbitration provisions even when the parties involved are no longer exchange members. See *Muh* v. *Newburger, Loeb & Co., Inc.,* 540 F.2d 970 (9th Cir. 1976) and *Isaacson* v. *Hayden Stone, Inc.,* 319 F.Supp. 929 (S.D.N.Y. 1970). In *Tullis,* the Fifth Circuit required arbitration even though Kohlmeyer & Co., the brokerage firm seeking to compel arbitration, was defunct. Also see *Nolde Bros., Inc.* v. *Local No. 358, Bakery & Confectionary Workers Union,* 45 U.S.L.W. 4251 (U.S. March 7, 1977). Thus, Allegaert's argument in opposition to the applicability of Section 28(b) based upon the fact that none of the Petitioners are now exchange members (Br., pp. 11-12)—an argument which the court below did not accept—is contrary to every decided case which has considered the issue.

ing to avoid arbitration has agreed to arbitration as a member of an exchange. *Id.* If this is the case, Section 28(b) applies. *Id.*

In reaching this result, the Fifth Circuit emphasized that the plaintiffs' proposed distinction (based on the type of transaction involved) "would be unworkable for practical reasons" and would result in "needlessly delaying and complicating litigation which typically already is difficult and burdensome." 551 F.2d at 636. It also stressed that, in recent years, "the scope of Rule 10b-5 and other securities provisions has grown to the point where a great number of disputes between exchange members may be stated in terms of the securities laws." 551 F.2d at 638. If arbitration "could be avoided at the will of any party claiming a securities law violation," the Congressional policy favoring exchange self-regulation "which is the basis of § 28(b) . . . would be weakened significantly." *Id.*

The decision of the Second Circuit in the instant case, however, needlessly complicates litigation and undermines exchange self-regulation in precisely the ways the Fifth Circuit's decision was intended to avoid. By limiting the overriding effect of Section 28 (b) of the Exchange Act in exchange member-member dispute situations based upon an attempted distinction between so-called "intramural" and non-intramural transactions, the court below adopted a "test" virtually identical to the "type of transaction" test the Fifth Circuit expressly rejected as contrary to statute, contrary to precedent and unworkable. Review by this Court thus is imperative to resolve a direct conflict between circuits, and to prevent application of a clearly erroneous standard of law in the circuit where most disputes between exchange members arise.

II. The Decision Below Conflicts With This Court's Decision in Prima Paint and With The Requirements of the Arbitration Act.

In the first section of his brief, Allegaert argues (i) that the decision below does not conflict with this Court's decision in *Prima Paint* v. *Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967) (hereinafter "*Prima Paint*") since it is "obviously irrelevant" and "simply has no bearing on this case" (Br., pp. 7 and 10), and (ii) that prior decisions of this Court which allegedly have found that arbitration of claims under Federal statute is "contrary to public policy and Congressional intent," provide adequate authority for the holding of the court below that arbitration may be denied based solely on the alleged "public interest" in a particular dispute and the alleged "uncertainty" of discovery. (App. A., pp. 9a-10a).[7]

It is true, as Allegaert notes, that *Prima Paint* involved "only common law claims." However, Alle-

[7] Allegaert also argues (Br., p. 10) that the Court of Appeals' application of its three-prong test of the "appropriateness" of arbitration based upon the facts in each particular case was merely *dictum* and that, with respect to Allegaert's securities law claims in particular, the court's decision was based solely on the rule in *Wilko* v. *Swan*. But the plain language of the decision below is to the contrary. (App. A., pp. 9a-10a.) The only mention of *Wilko* is in the paragraph following the discussion of the three-prong test, in which it is stated that "further support" for not permitting arbitration of Allegaert's securities law claims can be found in *Wilko* and one other case. (App. A., p. 10a.) The appellate court's choice of words thus negates the possibility that the discussion of *Wilko* was intended to be its only holding on the securities law issues, and instead suggests a clear intent to emphasize its three-prong test as the primary basis for its decision. As stated previously, *Wilko*, of course, does not in any way support the Court of Appeals' result, which is directly contrary to every prior case which has considered the applicability of *Wilko* to the exchange arbitration provisions.

gaert offers no explanation whatsoever as to why the clear holding of *Prima Paint*—that, under the Arbitration Act, the only issues to be considered are the "making and performance" of the agreement to arbitrate—applies with any less force where arbitration is sought with respect to claims under Federal statute. Nor does he offer any explanation—which the court below did not offer either—as to how the court's decision possibly can be squared with the unequivocal language of Sections 2 and 3 of the Arbitration Act, as interpreted in the *Prima Paint* decision. See Pet., pp. 11-13.

Moreover, contrary to Allegaert's assertions, this Court has never found any "public policy" against arbitration of statutory claims. Consistent with the Congressionally mandated Federal policy in favor of arbitration, established by the Arbitration Act, this Court has long expressed optimism with respect to the suitability of arbitration for resolving precisely such claims. See *Wilko, supra*, 346 U.S. at 431-432. Just two terms ago, in *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506, 519 (1974) the Court expressly rejected the "parochial concept" that only courts are capable of determining stock fraud questions under the securities laws, and arbitration has repeatedly been used or suggested as the appropriate forum for resolving disputes or claims arising under Federal statutes.[8]

Arbitration of Federal statutory claims under the Arbitration Act has been denied only under carefully

[8] See, for example, *United States for use of Capolino Sons, Inc.* v. *Electronic & Missile Facilities, Inc.*, 364 F.2d 705 (2d Cir. 1966); *Donahue* v. *Susquehanna Collieries Co.*, 138 F.2d 3 (3rd Cir. 1943); *Beckley* v. *Teyssier*, 332 F.2d 495 (9th Cir. 1964); *Evans* v. *Hudson Coal Co.*, 165 F.2d 970 (3d Cir. 1948); *Cavicchi* v. *Mohawk Manufacturing Co.*, 34 F.Supp. 852 (S.D.N.Y. 1940).

circumscribed circumstances, where denial of arbitration was *required* by a specific provision of law, which prevented arbitration of an *entire class* of claims. Thus, in *Wilko*, this Court refused to enforce a customer's agreement to arbitrate against his broker-dealer, only after finding that the customer's agreement (and *all* such agreements) to arbitrate was void under Section 14 of the Securities Act of 1933— a provision which does not apply to this case. (See Pet., pp. 16-18.)

Similarly, in *American Safety Equipment Corp.* v. *J. P. Maguire & Co.*, 391 F.2d 821, 826-827 (2d Cir. 1968), the seminal case on the arbitrability of antitrust claims, relied upon by all the decisions denying arbitration of antitrust and patent law claims identified by Allegaert in his brief (Br., p. 7 n. 3), the court denied arbitration only after it found that, if plaintiffs' allegations were correct, the agreement containing the arbitration clause itself would be an "instrument of illegality," void under the express prohibitions of the Sherman Act (See Pet., p. 15 n. 15).[9]

Alexander v. *Gardner-Denver Co.*, 415 U.S. 536 (1974) and *U.S. Bulk Carriers, Inc.* v. *Arguelles*, 400 U.S. 351 (1971), the only other decisions of this Court relied upon by Allegaert which involved arbitration of claims under Federal statute, arose under national labor relations statutes and do not involve the Arbitra-

[9] No similar finding is possible here, since two of the arbitration agreements sought to be enforced, the arbitration clauses of the NYSE and AMEX Constitutions, were entered into years before this dispute arose, in a wholly unrelated transaction. See Pet., p. 12 n. 11. *See, Tullis, supra*, 551 F.2d at 638, n. 8, and cases cited therein, further confirming the enforceability of these two agreements under the Arbitration Act.

tion Act in any way. Neither case was even cited by the court below.[10] Contrary to the implications of Allegaert's brief, however, even these cases, which are not remotely pertinent to the issues here, do not suggest any wholesale condemnation of arbitration as it applies to statutory claims. Instead, each case held only that an express right to a judicial hearing in a Federal district court guaranteed by a specific provision of Federal law was not barred by the labor arbitration agreements applicable therein.[11]

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[10] *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware*, 414 U.S. 117 (1973) and *Bernhardt* v. *Polygraphic Co.*, 350 U.S. 198 (1956), the only other decisions of this Court cited by Allegaert, do not support the decision of the court below in any way. In *Bernhardt*, the only issue was whether Federal or state law governed an arbitration agreement which, unlike any of the three agreements involved in the instant case, did not satisfy the requirements of the Arbitration Act. And in *Ware*, the Court held only that a California statutory provision which governed the arbitrability of a contractual claim for wages was not pre-empted by NYSE Rule 347, which the Court characterized as a mere "housekeeping" rule. 414 U.S. at 136. By contrast, this case, which does not raise any question of pre-emption, involves the enforceability of the arbitration provisions of the exchange Constitutions, which have been called "the most significant of the measures taken to implement the [exchange] self-regulation contemplated by the 1934 Act." See *Cocnen* v. *R. W. Pressprich & Co.*, 453 F.2d 1209, 1215 (2d Cir.), *cert. denied*, 406 U.S. 949 (1972), which the Court cited with approval in *Ware*, 414 U.S. at 135 n. 15, but which the decision below effectively overruled. The Court's holding in *Ware* also did not in any way conflict with the Arbitration Act since, if arbitration was barred under a specific provision of California law, then the arbitration agreement was invalid and unenforceable under § 2 of the Arbitration Act.

[11] Thus, in *Arguelles*, the only question was whether the "earlier, express, and alternative methods of collecting seamen's wages contained in 46 U.S.C. § 596 [i.e., an express grant of Federal district court jurisdiction over such claims] ha[d] been displaced by § 301 of the Labor Management Relations Act"—a question which a divided Court resolved in favor of allowing seamen optical

III. The Court of Appeals' Refusal to Permit Arbitration of the Trustee's Bankruptcy Act Claims Presents an Important Question of Federal Law Not Previously Considered by This Court.

Finally, Allegaert argues that the Court of Appeals never decided any important question of bankruptcy law, because it never reached what Allegaert apparently believes was an important issue in the case—*viz.*, whether the arbitration agreements at issue were executory contracts subject to rejection by Allegaert under Section 70b of the Bankruptcy Act.

Attempts to confuse the issues aside, the court below squarely held, for the first time in any decision that either side has unearthed, that a trustee in bankruptcy cannot be compelled to arbitrate claims which he initiates outside of the bankruptcy court under Sections 60, 67 and 70 of the Bankruptcy Act, even though no provision of the Bankruptcy Act releases the trustee from the bankrupt's inclusive arbitration agreements. It was this issue which the court below did decide and

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methods of recovery, after finding that nothing in § 301 suggested any intent by Congress to repeal the earlier and more specific statute, and also noting that federal courts had served a special protective role as guardians of seamen since the 18th century. 400 U.S. at 352 and 355-356. Similarly, in *Alexander* v. *Gardner-Denver*, the Court held only that arbitration of an employee's contractual rights under a collective bargaining agreement did not foreclose the employee's right to a trial *de novo* with respect to the special statutory rights available to him under Title VII of the Civil Rights Act of 1964. The Court expressly noted that: (i) the statute expressly provided the right to a trial *de novo*, as part of Congress' clear intent that Federal courts be assigned plenary powers to secure compliance with Title VII; (ii) that plaintiff's statutory rights were not within the scope of the arbitrator's authority, which by contract was limited to contractual issues; and (iii) that "legislative enactments in this area have long evinced a general intent to accord parallel or overlapping remedies against discrimination." 415 U.S. at 47.

which it was candid enough to acknowledge presented "significant questions regarding the interplay" of the two applicable Federal statutes—the Bankruptcy Act and the Arbitration Act. (App. A, p. 3a.)

Allegaert makes only a brief attempt to defend the appellate court's decision on this point by merely repeating the truism that a trustee in bankruptcy is allowed to avoid "defenses which would have been good against the bankrupt but not against its creditors." (Br., p. 14.) But the reason this statement is correct is that the Bankruptcy Act, by its own terms, relieves the trustee of certain otherwise valid defenses.[12] Neither the court below nor Allegaert, however, has made any showing that the obligation to submit to arbitration is a defense which may be avoided by the trustee within the terms of any such statutory provision.[13] The decision of the court below, contrary to every prior case, that a bankruptcy trustee suing alleged creditors of the estate in a plenary proceeding may *not* be compelled to arbitrate pursuant to the bankrupt's arbitration agreements, thus violates the fundamental principle of bankruptcy law that a trustee in bankruptcy is bound by the contractual obligations of the bankrupt unless released by statute, and should be reversed.[14]

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[12] For example, § 70 of the Bankruptcy Act expressly provides that the trustee may avoid any defenses which are fraudulent against creditors.

[13] Thus, to use the same example, no showing has been made as to how Petitioners' right to demand arbitration, arising out of Walston's decision to join the exchanges decades ago, can possibly be fraudulent against creditors under this provision.

[14] Allegaert also attempts to support the decision below by arguing that the contracts in which the arbitration clauses were contained were executory and therefore subject to his rejection. The Court of Appeals never reached this question. Had it done so there is little doubt it would have concluded, as did the District Court, that this argument rests on a "false assumption" because the contracts all had ceased to be executory well before the filing of the petition for bankruptcy, and thus no longer were subject to rejection under the Bankruptcy Act. (App. B, p. 23a.)

CONCLUSION

In his April 7, 1976 keynote address at the National Conference on the Causes of Popular Dissatisfaction with the Administration of Justice, Chief Justice Burger observed:

> "As the work of the courts increases, delays and costs will rise and the well-developed forms of arbitration should have wider use. Lawyers, judges and social scientists of other countries cannot understand our failure to make greater use of the arbitration process to settle disputes. I submit a reappraisal of the values of the arbitration process is in order, to determine whether, like the Administrative Procedures Act, arbitration can divert litigation to other channels."

In the Arbitration Act, the Congress of the United States reversed hundreds of years of hostility to arbitration in Anglo-American jurisprudence and gave Federal statutory sanction to agreements by which parties engaged in interstate commerce sought to avoid the "delays and costs" which the Chief Justice noted are on the rise in our congested courts. This case is a paradigm example of those delays and costs: notwithstanding three separate agreements between the parties selecting an arbitral forum for the resolution of *all* of their disputes, this case has been pending in the Federal courts for just short of two years; tens of thousands of dollars have been spent by each side on lawyers; and the dispute is not one inch closer to its ultimate resolu-

tion while the issue of its place of trial is fought over. The mandatory language of the Arbitration Act and the narrow judicial inquiry thereunder sanctioned by *Prima Paint* were designed to avoid this waste of court time, parties' time and money. But the court below has ignored that salutory purpose and its decision threatens to make the type of waste of time, effort and money which this case reflects the norm rather than the exception.

Respectfuly submitted,

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June 2, 1977

MOTION FILED
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IN THE

Supreme Court of the United States

October Term, 1976

No. 76-1478

H. Ross Perot, Electronic Data Systems Corporation, duPont Glore Forgan Incorporated, William K. Gayden, Morton H. Meyerson, Milledge A. Hart, III, Margot Perot, Mervin L. Stauffer, PHM & Co., Charleston Investment Company, E. D. Systems Corporation, Daniel J. Cullen, William D. Fleming, George T. Thomson, and Charles W. Cox,

Petitioners,

against

Winthrop J. Allegaert,
as Trustee of duPont Walston Incorporated,

Respondent,

and

New York Stock Exchange, Inc., Douglas E. DeTata, John J. Doughty, Allan Blair, and D. Tipp Cullen,

Additional Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE AND BRIEF AMICUS CURIAE OF THE AMERICAN STOCK EXCHANGE, INC., IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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IN THE

Supreme Court of the United States

October Term, 1976

No. 76-1478

H. ROSS PEROT, ELECTRONIC DATA SYSTEMS CORPORATION, DUPONT GLORE FORGAN INCORPORATED, WILLIAM K. GAYDEN, MORTON H. MEYERSON, MILLEDGE A. HART, III, MARGOT PEROT, MERVIN L. STAUFFER, PHM & CO., CHARLESTON INVESTMENT COMPANY, E. D. SYSTEMS CORPORATION, DANIEL J. CULLEN, WILLIAM D. FLEMING, GEORGE T. THOMSON, and CHARLES W. COX,

Petitioners,

against

WINTHROP J. ALLEGAERT,
as Trustee of duPont Walston Incorporated,

Respondent,

and

NEW YORK STOCK EXCHANGE, INC., DOUGLAS E. DETATA, JOHN J. DOUGHTY, ALLAN BLAIR, and D. TIPP CULLEN,

Additional Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE OF THE AMERICAN STOCK EXCHANGE, INC., IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

The American Stock Exchange, Inc., respectfully moves, under Rule 42(3) of the Rules of this Court, for leave to file a brief amicus curiae in support of the petition for cer-

tiorari. Counsel for the American Stock Exchange, Inc., attempted to obtain the consent of all the parties to the filing of the brief, but counsel for the respondent has denied consent.

The American Stock Exchange, Inc., is directly affected by the decision of the Court below, which expressly held a provision of the American Stock Exchange Constitution to be unenforceable in this case. As is explained more fully in the attached brief, eleven of the petitioners and additional respondents in this case, as well as the brokerage house represented by the respondent bankruptcy trustee, were members of the American Stock Exchange when the disputes in this case arose, and were required by a provision in the American Stock Exchange Constitution to submit disputes with other members to arbitration.

The American Stock Exchange, Inc., wishes to present the reasons why the decision of the Court below, holding the arbitration provision of the American Stock Exchange Constitution to be unenforceable in this case, seriously undermines the system of self-regulation of national securities exchanges that Congress established in the Securities Exchange Act of 1934.

WHEREFORE, the American Stock Exchange, Inc., prays that this motion be granted.

Respectfully submitted,

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IN THE

Supreme Court of the United States

October Term, 1976

No. 76-1478

H. Ross Perot, Electronic Data Systems Corporation, duPont Glore Forgan Incorporated, William K. Gayden, Morton H. Meyerson, Milledge A. Hart, III, Margot Perot, Mervin L. Stauffer, PHM & Co., Charleston Investment Company, E. D. Systems Corporation, Daniel J. Cullen, William D. Fleming, George T. Thomson, and Charles W. Cox,

Petitioners,

against

Winthrop J. Allegaert,
as Trustee of duPont Walston Incorporated,

Respondent,

and

New York Stock Exchange, Inc., Douglas E. DeTata, John J. Doughty, Allan Blair, and D. Tipp Cullen,

Additional Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF AMICUS CURIAE OF THE AMERICAN STOCK EXCHANGE, INC., IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

This brief in support of the petition for a writ of certiorari, is submitted by the American Stock Exchange, Inc., as amicus curiae. For the reasons set forth below, the American Stock Exchange, Inc., believes that the petition presents an extremely serious issue, not previously resolved by this Court, concerning the self-regulation of national securities exchanges under the Securities Exchange Act of 1934.

The Interest of the Amicus Curiae

The American Stock Exchange, Inc., is a national securities exchange registered pursuant to Section 6 of the Securities Exchange Act of 1934, 15 U.S.C. §78 f. Petitioner-defendant duPont Glore Forgan Incorporated ("DGF"), and duPont Walston Incorporated ("Walston"), a bankrupt brokerage house whose federal securities fraud claims are being asserted by the respondent-plaintiff bankruptcy trustee, were member corporations of the amicus curiae during the period covered by the complaint in this case. Ten of the other petitioners and additional respondents, including nine of the "Defendant Directors" of Walston (Complaint ¶18), were allied members of the amicus curiae ("the allied members") during that period.*

* Petitioners Morton H. Meyerson, Mervin L. Stauffer, Daniel J. Cullen, William D. Fleming, George T. Thomson and Charles W. Cox, and Additional Respondents Douglas E. DeTata, John J. Doughty, Allan Blair and D. Tipp Cullen.

Article IV, Section 1(b) of the American Stock Exchange Constitution provides that a director of a member corporation may become an allied member of the Exchange if he satisfies certain requirements and signs a pledge to abide by the Constitution and Rules of the Exchange (2 American Stock Exchange Guide (CCH) ¶9031).

As members of the American Stock Exchange, Walston, DGF and the allied members agreed to be bound by Article VIII, Section 1 of the American Stock Exchange Constitution which provides that "[m]embers . . . shall arbitrate all controversies arising in connection with their business between or among themselves . . ." (2 American Stock Exchange Guide (CCH) ¶9062).*

The Court below held that this provision of the amicus curiae's Constitution (as well as a similar provision of the New York Stock Exchange Constitution) is enforceable only with respect to disputes which the Court characterized as "mere internal brokerage industry squabble[s]", and not with respect to disputes involving "broad questions of policy" under the federal securities laws.

It will be the purpose of the amicus curiae in this brief to show that its arbitration procedures are an appropriate and necessary method of resolving disputes among its members even when those disputes involve claims under the federal securities laws, that the amicus curiae was authorized by the Securities Exchange Act of 1934 to require its members to arbitrate such disputes, and that consequently the decision below significantly impairs the amicus curiae's right to self-regulation which Congress granted in the Securities Exchange Act of 1934.

* Article I, Section 3(b) of the American Stock Exchange Constitution provides that the term "member" includes allied members (2 American Stock Exchange Guide (CCH) ¶9003).

ARGUMENT

The decision below seriously undermines the system of self-regulation of national securities exchanges established by the Securities Exchange Act of 1934.

This case raises an issue of importance to the entire securities industry and vital to national securities exchanges, namely, whether the constitution and rules of a national securities exchange can require arbitration of disputes between members of the exchange when the disputes involve claims under the federal securities laws and the Bankruptcy Act.

The decision of the Court below, that arbitration of such disputes cannot be compelled, substantially invalidates the provisions in the Constitutions of the American and New York Stock Exchanges that require arbitration of disputes between exchange members—provisions that the Second Circuit once recognized are "the most significant of the measures taken to implement the self-regulation contemplated by the 1934 Act . . . ." *Coenen* v. *R. W. Pressprich & Co.*, 453 F.2d 1209, 1215 (2d Cir.) *cert. denied*, 406 U.S. 949 (1972). The decision below is contrary to the mandate of the Securities Exchange Act of 1934, 15 U.S.C. §§78a *et seq.*, and the United States Arbitration Act, 9 U.S.C. §§1 *et seq.*, and contrary to the previous case law, which has consistently held that the provisions of the American and New York Stock Exchanges requiring arbitration of disputes between exchange members are enforceable.

The Court below apparently lost sight of the fact that the federal securities fraud claims in this case constitute a

dispute between members of the American Stock Exchange. Walston's bankruptcy trustee claims that DGF and the allied members made misrepresentations to Walston, which induced Walston to enter into the Realignment Agreements. Those claims, that the alleged misrepresentations violated Rule 10b-5 and various other anti-fraud provisions of the federal securities laws,* are claims of Walston and, as such, are subject to arbitration in accordance with Article VIII, Section 1 of the American Stock Exchange Constitution.

The claims under the Bankruptcy Act, 11 U.S.C. §§96, 107 and 110, may also be effectively, fairly and promptly decided in arbitration. Arbitration is the industry practice as evidenced by the published rules of the New York and American Stock Exchanges. Public policy is not opposed to settlement of disputes in this fashion; to the contrary, arbitration is less expensive and just as sensitive to the equities of the commercial world under the panels of experienced arbitrators as a proceeding in court. As successor in interest to Walston, a member firm of both the New York and American Stock Exchanges, the trustee requires no relief from its commitment to settle disputes with other member firms by arbitration.

The Court below also proceeded on an erroneous assumption that the arbitration procedures of the American Stock Exchange are procedurally "inappropriate" for resolving

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* Three counts allege violations of §10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), and Rule 10b-5, 17 C.F.R. §240.10b-5; one count violations of Section 29(b) of the Exchange Act, 15 U.S.C. §78cc(b); one count violations of Section 17(a) of the Securities Act of 1933, 15 U.S.C. §77q(a); one count violations of Section 12(2) of the Securities Act, 15 U.S.C. §77l(2); and one count violations of Section 15 of the Securities Act, 15 U.S.C. §77o, and Section 20(a) of the Exchange Act, 15 U.S.C. §78t(a).

disputes involving "broad questions of policy" under the federal securities laws, even when the dispute is between exchange members. As this brief will show, arbitration pursuant to the American Stock Exchange Arbitration Rules ("the Arbitration Rules") is not only an appropriate method of resolving the types of disputes presented in this case but is, in many respects, equally effective or even preferable to an action in the federal courts.

Of primary importance is the fact that the arbitrators will be persons of experience in the securities industry. There is no possibility that the case will be decided by a jury of laymen unfamiliar with the terminology and practices in this field.* Arbitration Rules 601 and 602 require that a dispute between exchange members be decided by a panel of three or five arbitrators drawn from a list of exchange members, partners of member firms and officers of member corporations (2 American Stock Exchange Guide (CCH) ¶¶9541, 9542). Such a panel (truly a jury of the parties' peers) is certainly an appropriate forum for deciding the questions presented in this case, such as whether certain of the defendants misrepresented to the Walston Board of Directors the financial condition of DGF and of Walston (Complaint ¶54) and whether the "numerous, lengthy and complex" Realignment Agreements were "inequitable . . . to Walston and excessively favorable to the Perot Interests" (Complaint ¶50).

* For a discussion of the widespread dissatisfaction with the use of the jury in the trial of civil cases, see Justice Schaefer's address before the National Conference on the Causes of Popular Dissatisfaction with the Administration of Justice. Schaefer, *Is the Adversary System Working in Optimal Fashion?* 70 F.R.D. 159, 160 (1976).

Second, the Arbitration Rules augmented by statute can be used to compel to production of relevant documents and the appearance of witnesses. Arbitration Rule 608 provides that "[t]he arbitrators and any attorney of record in the arbitration proceeding shall have such powers of subpoena as may be provided by law" (2 American Stock Exchange Guide (CCH) ¶9548). Both Section 7 of the United States Arbitration Act, 9 U.S.C. §7, and Section 7505 of the New York CPLR authorize the issuance of subpoenas to compel production of documents and attendance of witnesses. This procedure, in which document demands are either made by the tribunal or closely supervised by it, can hardly be said to be inappropriate in complex litigation. It does not differ essentially from the procedure recommended by the *Manual For Complex Litigation.**

Third, the American Stock Exchange Constitution provides (Article VIII, Section 4) that the decision of the arbitrators is final and not subject to protracted appeals (2 American Stock Exchange Guide (CCH) ¶9065).

Despite the advantages of arbitration to the parties to the dispute, the Court below reasoned that the "public interest" is better protected by a trial in the federal courts ". . . where a complete record is kept of the proceedings and findings and conclusions are made . . . ." This position

* *See* Section 1.10 of the *Manual For Complex Litigation* (1973): "The Federal Rules of Civil Procedure contemplate that discovery in the ordinary case will be directed by counsel with infrequent intervention by the judge when counsel are unable to agree. This usual pattern, however, may be ineffective in complex cases if they are to be processed expeditiously. Both the bench and bar have long been in nearly unanimous agreement on the fundamental principle that a complex case must be managed by a judge with a firm hand."

claims too much. Civil disputes do not usually contain elements of such basic public importance that resolution in a public forum is required. Settlements of civil cases could not be encouraged as they are if the outcome required public court action. Most private disputes can be resolved privately—by settlement or by arbitration. The decision below implicitly casts suspicion on arbitration as a means of resolving any significant dispute. This seems unwise and is not supported by precedent or any clear public policy.

In short, there is nothing "inappropriate" about the members of the American Stock Exchange agreeing that disputes among themselves, including disputes involving allegations of fraud under the federal securities laws, will be resolved by arbitration. Furthermore, Section 28(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78 bb(b), and Section 2 of the United States Arbitration Act, 9 U.S.C. §2, guarantee the right of the members of the American Stock Exchange to make such an agreement.* That agreement is embodied in Article VIII, Section 1 of the American Stock Exchange Constitution, which the courts, prior to the decision below, have consistently held enforceable in disputes between exchange members, even when the disputes involve claims under the federal securities laws. *See e.g., In re Revenue Properties Litigation Cases,* 451 F.2d 310 (1st Cir. 1971), *Axelrod & Co.* v. *Kordich, Victor & Neufeld,* 451 F.2d 838 (2d Cir. 1971). *Coenen* v. *R. W. Pressprich & Co.,* 453 F.2d 1209 (2d Cir.), *cert. denicd,* 406 U.S. 949 (1972); *Brown* v. *Gilligan, Will & Co.,* 287 F. Supp. 766 (S.D.N.Y. 1968).

* This point is discussed more fully in the Petition for Certiorari, pages 19-21, and in the Brief of Respondent New York Stock Exchange, Inc., In Support of Petition.

Conclusion

For the foregoing reasons, the petition should be granted and a writ of certiorari should be issued to review the decision below.

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